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Form 10-Q

DOCUMENT SECURITY SYSTEMS INC - DMC

Filed: November 16, 2009 (period: September 30, 2009)

Quarterly report which provides a continuing view of a company's financial position

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2009

1-32146

Commission file number



DOCUMENT SECURITY SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

New York

(State of incorporation)

16-1229730

(IRS Employer Identification Number)

**28 Main Street East, Suite 1525
Rochester, NY 14614**

(Address of principal executive office)

(585) 325-3610

(Registrant's telephone number)

Indicate by check mark whether the registrant:

(1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports)

And

(2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files)*

Yes No

* The issuer has not yet been phased into the interactive data requirements

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes No

Applicable only to corporate issuers

As of November 13, 2009 (the most recent practicable date), there were 15,182,062 shares of the issuer's Common Stock, \$0.02 par value per share, issued.

DOCUMENT SECURITY SYSTEMS, INC.
FORM 10-Q
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PART I

FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS

DOCUMENT SECURITY SYSTEMS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
As of

	September 30, 2009 (unaudited)	December 31, 2008
	<u> </u>	<u> </u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 423,076	\$ 87,820
Restricted cash	-	131,004
Accounts receivable, net of allowance of \$36,000 (\$50,000- 2008)	1,341,464	1,284,208
Inventory	237,623	359,034
Loans to employees	-	67,781
Prepaid expenses and other current assets	125,129	75,066
Total current assets	<u>2,127,292</u>	<u>2,004,913</u>
Assets held for sale	255,372	-
Fixed assets, net	1,349,020	1,517,357
Other assets	315,508	264,529
Goodwill	1,315,721	1,396,734
Other intangible assets, net	<u>1,972,375</u>	<u>2,873,789</u>
Total assets	<u><u>\$ 7,335,288</u></u>	<u><u>\$ 8,057,322</u></u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,779,018	\$ 1,411,942
Accrued expenses & other current liabilities	933,951	1,312,745
Deferred revenue & customer deposits	25,273	30,193
Revolving notes from related parties	3,033,000	-
Short-term debt, net of discount of \$58,000 (\$247,000 -2008)	841,722	652,511
Current portion of capital lease obligations	75,721	78,367
Total current liabilities	<u>6,688,685</u>	<u>3,485,758</u>
Liabilities held for sale	24,036	-
Revolving notes from related parties	-	2,283,000
Capital lease obligations	206,956	210,365
Deferred tax liability	66,092	51,878
Commitments and contingencies (see Note 9)		
Stockholders' equity		
Common stock, \$.02 par value; 200,000,000 shares authorized, 14,974,062 shares issued and outstanding (14,369,764 in 2008) (325,000 subscribed in 2008)	299,481	287,395
Additional paid-in capital	35,422,864	35,538,695
Common stock subscriptions receivable	-	(1,300,000)
Accumulated deficit	<u>(35,372,826)</u>	<u>(32,499,769)</u>
Total stockholders' equity	<u>349,519</u>	<u>2,026,321</u>

Total liabilities and stockholders' equity

\$ 7,335,288 \$ 8,057,322

See accompanying notes

DOCUMENT SECURITY SYSTEMS, INC. AND SUBSIDIARIES
Consolidated Statements of Operations

(unaudited)

Three Months Ended September 30,

Nine Months Ended September 30,

2009

2008

2009

2008

Revenue				
Security and commercial printing	\$ 2,246,700	\$ 1,334,184	\$ 6,605,209	\$ 3,421,437
Technology license royalties and digital solutions	204,334	189,267	618,908	1,426,182
Legal products	101,611	150,129	355,107	482,561
Total Revenue	<u>2,552,645</u>	<u>1,673,580</u>	<u>7,579,224</u>	<u>5,330,180</u>
Costs of revenue				
Security and commercial printing	1,516,188	635,934	4,546,512	2,027,636
Technology license royalties and digital solutions	3,507	3,507	10,521	10,521
Legal products	56,073	86,120	178,892	257,536
Total costs of revenue	<u>1,575,768</u>	<u>725,561</u>	<u>4,735,925</u>	<u>2,295,693</u>
Gross profit	976,877	948,019	2,843,299	3,034,487
Operating expenses:				
Selling, general and administrative	1,436,533	1,789,790	4,139,751	5,828,136
Research and development	61,317	72,876	223,409	322,106
Impairment of patent defense costs	-	-	-	291,581
Amortization of intangibles	323,936	540,934	971,068	1,605,104
Operating expenses	<u>1,821,786</u>	<u>2,403,600</u>	<u>5,334,228</u>	<u>8,046,927</u>
Operating loss	(844,909)	(1,455,581)	(2,490,929)	(5,012,440)
Other income (expense):				
Interest income	18,140	484	18,140	569
Gain (loss) on foreign currency transactions	(1,453)	7,534	10,329	(16,652)
Interest expense	(57,998)	(41,208)	(207,172)	(95,098)
Amortization of note discount	(63,756)	-	(189,211)	-
Loss on sale of patent assets	-	(1,169,947)	-	(1,169,947)
Other income	-	-	-	125,795
Loss before income taxes	<u>(949,976)</u>	<u>(2,658,718)</u>	<u>(2,858,843)</u>	<u>(6,167,773)</u>
Income tax expense	4,738	4,738	14,214	14,260
Net loss	<u>\$ (954,714)</u>	<u>\$ (2,663,456)</u>	<u>\$ (2,873,057)</u>	<u>\$ (6,182,033)</u>

Net loss per share -basic and diluted:	\$	(0.06)	\$	(0.19)	\$	(0.20)	\$	(0.45)
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Weighted average common shares outstanding, basic and diluted		<u>14,711,105</u>		<u>14,286,192</u>		<u>14,510,056</u>		<u>13,879,891</u>
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See accompanying notes

Consolidated Statements of Cash Flows
For the Nine Months Ended September 30,

(unaudited)

	2009	2008
Cash flows from operating activities:		
Net loss	\$ (2,873,057)	\$ (6,182,033)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	1,221,103	1,841,975
Stock based compensation	(78,725)	1,536,403
Impairment of patent defense costs	-	291,581
Amortization of note discount	189,211	-
Impairment of patent defense costs		1,169,947
Decrease in restricted cash	-	19,845
(Increase) decrease in assets:		
Accounts receivable	(88,690)	(167,348)
Inventory	28,890	29,170
Prepaid expenses and other assets	(33,261)	(43,049)
Increase (decrease) in liabilities:		
Accounts payable	367,454	(65,053)
Accrued expenses and other liabilities	(211,654)	143,914
Deferred revenue and customer deposits	(4,920)	(691,713)
Net cash used by operating activities	<u>(1,483,649)</u>	<u>(2,116,361)</u>
Cash flows from investing activities:		
Purchase of fixed assets	(18,255)	(226,716)
Decrease in restricted cash	131,004	-
Proceeds from the sale of patent assets	-	500,000
Purchase of other intangible assets	(183,630)	(1,144,351)
Net cash used by investing activities	<u>(70,881)</u>	<u>(871,067)</u>
Cash flows from financing activities:		
Borrowing on revolving note- related parties	1,030,000	1,558,000
Repayment on revolving note- related parties	(280,000)	
Borrowings on short-term credit facility	-	500,000
Repayment on short-term credit facility	-	(500,000)
Payments of capital lease obligations	(101,717)	(75,411)
Issuance of common stock, net	1,241,503	1,205,174
Net cash provided by financing activities	<u>1,889,786</u>	<u>2,687,763</u>
Net increase (decrease) in cash and cash equivalents	335,256	(299,665)
Cash and cash equivalents beginning of period	87,820	742,468
Cash and cash equivalents end of period	<u>\$ 423,076</u>	<u>\$ 442,803</u>

See accompanying notes.

DOCUMENT SECURITY SYSTEMS, INC.
NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2009
(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 8.03 of Regulation S-X for smaller reporting companies. Accordingly, these statements do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying balance sheets and related interim statements of operations and cash flows include all adjustments, consisting only of normal recurring items, necessary for their fair presentation in accordance with U.S. generally accepted accounting principles. All significant intercompany transactions have been eliminated.

Interim results are not necessarily indicative of results expected for a full year. For further information regarding Document Security Systems, Inc (the "Company") accounting policies, refer to the audited consolidated financial statements and footnotes thereto included in the Company's Form 10-K for the fiscal year ended December 31, 2008.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates and assumptions. In preparing these financial statements, the Company has evaluated events and transactions for potential recognition or disclosure. These financial statements have not been updated for subsequent events occurring after November 16, 2009.

Reclassifications - Certain prior period amounts in the accompanying consolidated financial statements and notes thereto have been reclassified to current period presentation. These classifications had no effect on the results of operations for the period presented. These reclassifications include the combination of technology license royalties and digital solutions revenue items into a single revenue item and cost of sale item.

Restricted Cash - In July 2007, the Company established a restricted cash balance of 87,500 British pounds, as collateral for a deed of guarantee that was required by the English Court of Appeals in order for the Company to pursue an appeal in that court. On March 19, 2008, the Company was notified that its appeal was denied and that the Company owed the European Central Bank, the successful party in the appeal, the 87,500 British pounds. On May 14, 2008, the Company made a payment of 87,500 British pounds to the European Central Bank as an interim payment of the appeal costs pending final assessment by the Court which was made on July 31, 2009. In August 2009, the funds were used to pay a portion of the appeal costs owed by the Company.

Fair Value of Financial Instruments – The Company discloses fair value information about financial instruments. Fair value estimates discussed herein are based upon certain market assumptions and pertinent information available to management as of September 30, 2009. These financial instruments include cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, revolving note payable, short-term debt and capital leases. Fair values were assumed to approximate carrying values for these financial instruments since they are short-term in nature and their carrying amounts approximate fair values or they are receivable or payable on demand. The fair value of the Company's revolving note payable, short-term debt and capitalized lease obligations is estimated based upon the quoted market prices for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities. The carrying value approximates the fair value of these debt instruments as of September 30, 2009 and December 31, 2008.

Continuing Operations - The Company has incurred significant net losses in previous years. The Company's ability to fund its capital requirements out of its available cash and cash generated from its operations depends on a number of factors. Some of these factors include the Company's ability to (i) increase commercial and security printing and plastic card sales and (ii) increase sales of the Company's digital products. While the Company has approximately \$423,000 in cash and approximately \$567,000 of funds available to it under various credit facilities as of September 30, 2009, the Company will likely need to raise additional funds in the future in order to fund its working capital needs. In December 2008, the Company borrowed \$900,000 of short term debt in conjunction with its acquisition of substantially all of the assets of DPI, a commercial printer, which matures in December 2009. Furthermore, the Company has two credit facilities with related parties that will be due in January 2010. As of September 30, 2009, there is \$3,033,000 outstanding under these credit facilities with related parties. The total amount due may be up to \$3,600,000. In the event that the Company cannot pay these credit facilities when due, the Company believes that it will be able to extend the terms of these notes, negotiate with the lenders other means of satisfying these credit facilities, including the payment of amounts due in the form of the Company's equity, or refinance the amounts due with new debt instruments. There can be no assurance that such additional financing, will be available on terms acceptable to the Company or at all. Failure to raise the funds necessary to finance future cash requirements would adversely affect the Company's ability to pursue its strategy and could negatively affect operations in future periods. The accompanying financial statements do not reflect any adjustments that may be necessary in the event the Company is unsuccessful in its fundraising efforts.

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board ("FASB") issued SFAS 141(r), *Business Combinations*, now Accounting Standards Codification ("ASC") 805, which addresses the accounting and disclosure for identifiable assets acquired, liabilities assumed, and noncontrolling interests in a business combination. In April 2009, the FASB issued FASB Staff Position No. FAS 141(r)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (FSP FAS 141(r)-1), which amended certain provisions of SFAS 141(r) related to the recognition, measurement, and disclosure of assets acquired and liabilities assumed in a business combination that arise from contingencies. SFAS 141(r) and FSP FAS 141(r)-1 became effective in the first quarter of 2009, and did not have a material impact on the consolidated financial statements.

In June 2008, the EITF reached a consensus in Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock" ("EITF 07-5"), now ASC 815. This Issue addresses the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock, which is the first part of the scope exception in paragraph 11(a) of SFAS 133. EITF 07-5 is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early application is not permitted. The adoption of EITF 07-5 during the first quarter of 2009 did not have a material impact on the consolidated financial statements.

In April 2009, the FASB issued FSP No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP 157-4), now ASC 820, which provides additional guidance for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. FSP 157-4 also provides additional guidance on circumstances that may indicate that a transaction is not orderly. This guidance is effective for interim reporting periods ending after June 15, 2009. The adoption of FSP 157-4 during the second quarter of 2009 did not have a material impact on the consolidated financial statements.

In April 2009, the FASB issued FSP No. 107-1 and APB 28-1, *Interim Disclosures About Fair Value of Financial Instruments* (FSP 107-1 and APB 28-1), now ASC 825, which require disclosures about fair value of financial instruments for interim reporting periods. This guidance is effective for interim reporting periods ending after June 15, 2009. The adoption of FSP No. 107-1 and APB 28-1 during the second quarter of 2009 did not have a material impact on the consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events" ("SFAS No. 165"), now ASC 855, to incorporate accounting guidance that originated as auditing standards into the body of authoritative literature issued by the FASB. SFAS No. 165 requires the evaluation of subsequent events through the date the financial statements are issued or are available for issue and the disclosure of the date through which subsequent events were evaluated and the basis for that date. This statement is effective for interim and annual financial periods ending after June 15, 2009. The Company adopted the requirements of SFAS No. 165 for the period ending June 30, 2009. The adoption of SFAS No. 165 did not have a significant impact on our consolidated financial position, results of operations or cash flows. See Note 1 – Basis of Presentation and Significant Accounting Policies.

FASB Codification. In July 2009, the FASB issued SFAS No. 168, “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (“GAAP”) (as amended)” (“SFAS No. 168”), now ASC 105, making the FASB Accounting Standards Codification the single source of authoritative nongovernmental U.S. GAAP. The Codification is not intended to change GAAP, however, it will represent a significant change in researching issues and referencing U.S. GAAP in financial statements and accounting policies. This statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company has adopted the new codification standards.

2. Inventory

Inventory approximately consisted of the following:

	September 30, 2009 (unaudited)	December 31, 2008
Finished Goods	\$ 53,000	\$ 138,000
Work in process	75,000	121,000
Raw Materials	110,000	100,000
	<u>\$ 238,000</u>	<u>\$ 359,000</u>

3. Other Intangible Assets

Other intangible assets are comprised of the following:

	Useful Life	September 30, 2009 (unaudited)			December 31, 2008		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Other intangibles	5 years	\$ 756,300	\$ 590,570	\$ 165,730	\$ 756,300	\$ 495,424	\$ 260,876
Patent acquisition and defense costs	Varied (1)	4,729,889	3,583,803	1,146,086	4,729,889	2,732,422	1,997,467
Patent application costs	Varied (2)	788,526	127,967	660,559	718,875	103,429	615,446
		<u>\$ 6,274,715</u>	<u>\$ 4,302,340</u>	<u>\$ 1,972,375</u>	<u>\$ 6,205,064</u>	<u>\$ 3,331,275</u>	<u>\$ 2,873,789</u>

(1)- patent rights are amortized over their expected useful life which is generally the legal life of the patent. As of September 30, 2009 the weighted average remaining useful life of these assets in service was 1 year.

(2)- patent rights are amortized over their expected useful life which is generally the legal life of the patent. As of September 30, 2009 the weighted average remaining useful life of these assets in service was 15 years.

4. Short Term Debt

Revolving Notes- Related Parties- On January 4, 2008, the Company entered into a Credit Facility Agreement with Fagenson & Co., Inc., as agent, a related party to Robert B. Fagenson, the Chairman of the Company's Board of Directors. Under the Fagenson Credit Agreement, the Company can borrow up to a maximum of \$3,000,000 from time to time up to and until January 4, 2010. The advances are generally limited to \$400,000 unless otherwise mutually agreed upon by both parties per fiscal quarter, with the exception of \$600,000 that can be advanced at any time for patent litigation related bills. Any amount borrowed by the Company pursuant to the Fagenson Credit Agreement will have an annual interest rate of 2% above LIBOR and will be secured by the Common Stock of Plastic Printing Professionals, Inc., (“P3”) the Company's wholly owned subsidiary. Interest is payable quarterly in arrears and the principal is payable in full at the end of the term under the Fagenson Credit Agreement. In addition, on January 4, 2008, the Company also entered into a Credit Facility Agreement with Patrick White, the Company's Chief Executive Officer and a member of the Board of Directors. Under the White Credit Agreement, the Company can borrow up to \$600,000 from time to time up to and until January 4, 2010. Any amount borrowed by the Company pursuant to the White Credit Agreement will have an annual interest rate of 2% above LIBOR and is secured by the accounts receivable of the Company, excluding the accounts receivable of P3. Interest is payable quarterly in arrears and the principal is payable in full at the end of the term under the White Credit Agreement. Mr. White can accept common stock as repayment of the loan upon a default. Under the terms of the agreement the Company is required to comply with various covenants.

As of September 30, 2009, the Company had outstanding \$450,000 under the White Credit Agreement, \$2,583,000 under the Fagenson Credit Agreement. Interest expense for the first nine months of 2009 amounted to approximately \$84,000 for these agreements. As of September 30, 2009, approximately \$146,000 of interest expense is included in accrued expenses. As of September 30, 2009, the Company was in default of both agreements due to a failure to pay interest when due. Both Fagenson & Co., Inc. and Patrick White have waived the defaults through January 1, 2010.

Short-Term Debt- On December 18, 2008, the Company's wholly owned subsidiary, Secuprint, Inc. (dba DPI Secuprint, Inc.) entered a Secured Promissory Note with Baum Capital Investments Inc. ("Baum Capital Note") in the principal amount of up to \$900,000 to pay for most of the cash portion of the purchase price of the Company's acquisition of substantially all of the assets of DPI of Rochester, LLC. The Baum Capital Note has a one-year term, is secured by all of the assets of DPI Secuprint and has an annual interest rate of 15%, with a reduction to 12%, depending on whether certain conditions are met after three months. The note is subject to pre-payment provisions if, among other provisions, DPI Secuprint's cash receipts do not exceed its cash expenditures for any two consecutive months during the term. As of September 30, 2009, the Company believes that it is in compliance with all of the covenants of the Note. Interest expense for the first nine months of 2009 amounted to approximately \$100,000 for this agreement, of which approximately \$9,000 is included in accrued expenses as of September 30, 2009.

In conjunction with the Baum Capital Note, the Company issued warrants to purchase up to a total of 250,000 shares of the Company's common stock at an average price of \$2.00 per share. The warrants are exercisable as of February 16, 2009 and expire on December 17, 2013. The fair value of the warrants of approximately \$256,000 was determined using the Black Scholes option pricing model, and was recorded as discount on debt and will be amortized over the term of the Note. Amortization of approximately \$189,000 was recorded in the first nine months of 2009.

5. Shareholders' Equity

Restricted Stock – As of September 30, 2009, there are 50,000 unvested restricted shares granted to an employee that vests proratably through December 2013. In addition, there are 45,000 restricted shares that will vest only upon the occurrence of certain events prior to May 3, 2012, which include, among other things a change of control of the Company or other merger or acquisition of the Company, the achievement of certain financial goals, including among other things a successful result of the Company's patent infringement lawsuit against the European Central Bank. These 45,000 shares, if vested, would result in the recording of stock based compensation expense of approximately \$563,000, the grant date fair value, over the period beginning when any of the contingent vesting events is deemed to be probable over the expected requisite service period. As of September 30, 2009, vesting is not considered probable and no compensation expense has been recognized related to the performance grants. During the first nine months of 2009, the Company retired 212,500 of unvested restricted stock as the result of the resignations of two employees.

Stock Subscription Agreement - On June 3, 2009, the Company and Walton Invesco, Inc. executed a letter agreement terminating the parties' Share Purchase Agreement dated June 25, 2008 and any obligations outstanding thereunder. Under the Share Purchase Agreement, Walton had agreed to purchase 350,000 shares of the Company's Common Stock for \$1,400,000, or \$4.00 per share, payable in five installments over a two-year period. The first installment of \$100,000 was paid. A second payment installment in the amount of \$300,000 was due on December 25, 2008, but was not paid. As a result, the parties agreed to terminate the Share Purchase Agreement which resulted in the cancellation of 325,000 of the Company's shares as of June 3, 2009.

Stock Issued in Private Placements - In June, 2008 the Company entered into two Share Purchase Agreements pursuant to which the Company agreed to sell a total of 500,000 shares of the Company's common stock for an aggregate purchase price of \$2,000,000. Pursuant to the terms of the first Agreement, the Company sold 150,000 shares of Common Stock to the Purchaser for \$600,000 payable on June 25, 2008. Pursuant to the terms of the first Agreement, the Purchaser could not sell the 150,000 shares of Common Stock purchased thereunder earlier than June 25, 2009. Pursuant to the terms of the second Agreement, the Company sold 350,000 shares of Common Stock for \$1,400,000, with \$100,000 payable on June 25, 2008 and the remaining \$1,300,000 payable in six-month installments over a two-year period which was cancelled on June 3, 2009 as per above.

On August 20, 2008, the Company entered into an agreement with Trebuchet Capital Partners, LLC who agreed to pay substantially all of the litigation costs associated with pending validity proceedings initiated by the ECB in eight European countries relating to the Company's European Patent 0 455 750B1 that the Company has claimed the ECB infringed in printing of the Euro currency. Trebuchet has also purchased 100,000 shares of the Company's common stock, subject to the American Stock Exchange approving the listing of such shares, for an aggregate purchase price of \$400,000, the proceeds of which were used by the Company to pay existing litigation cost.

Between May 29, 2009 and June 22, 2009, the Company sold 56 investment units in a private placement at a price of \$10,000 per unit for aggregate proceeds of \$560,000 less \$44,000 in expenses, consisting of 400,000 shares of common stock and warrants to purchase an aggregate of 80,000 shares of common stock. The estimated fair market value of these warrants was determined using the Black Scholes option pricing model at approximately \$80,000. On July 15, 2009, the Company sold 24.5 investment units for \$10,000 per unit for gross cash proceeds of \$245,000, consisting of 175,000 shares of Common Stock and Warrants to purchase an aggregate of 35,000 shares of Common Stock. The estimated fair market value of these warrants was determined using the Black Scholes option pricing model at approximately \$34,000. On August 24, 2009, the Company completed the sale of 7 investment units in a private placement pursuant to subscription agreements with one accredited investor dated the same date. In the transaction, the Company sold 7 investment units for \$10,000 per unit for gross cash proceeds of \$70,000, consisting of 50,000 shares of common stock and warrants to purchase an aggregate of 10,000 shares of common stock. The estimated fair market value of these warrants was determined using the Black Scholes option pricing model at approximately \$10,000. Each investment unit consisted of 7,142 shares of its common stock and five-year warrants to purchase up to an aggregate of 1,427 shares of its common stock at an exercise price of \$2.00 per share.

On September 4, 2009, the Company completed the sale of 44 investment units in a private placement pursuant to subscription agreements with three accredited investors dated the same date. Each investment unit is comprised of 6,250 shares of the Company's common stock and five year warrants to purchase 1,250 shares of common stock at an exercise price of \$2.00 per share. In the transaction, the Company sold 44 investment units for \$10,000 per unit for gross cash proceeds of \$440,000, less expenses of \$52,000, consisting of 275,000 shares of common stock and warrants to purchase an aggregate of 55,000 shares of common stock. The estimated fair market value of these warrants was determined using the Black Scholes option pricing model at approximately \$54,000.

Stock Options – During the nine months ended September 30, 2009, the Company issued options to purchase 40,000 of its common shares at an exercise price of \$1.86 per share to non-employee directors pursuant to the 2004 Non-Employee Officer Director Stock Option Plan that vest at the end of one year of service on the Company's Board of Directors. The fair value of these options amounted to approximately \$28,000 determined by utilizing the Black Scholes option pricing model. In addition, the Company issued options to purchase 288,000 of its common shares at an exercise price of \$4.00 per share under the Company's 2004 Employees' Stock Option Plan to certain employees, including 50,000 options to its chief financial officer and 50,000 options to its vice president of operations who is also a board member. The fair value of these options amounted to approximately \$145,000 determined by utilizing the Black Scholes option pricing model. The Company records stock-based payment expense related to these options based on the grant date fair value in accordance with FASB 123R. During the nine months ended September 30, 2009, the Company cancelled 168,000 unvested options due to employee terminations.

Stock-Based Compensation - Stock-based compensation includes expense charges for all stock-based awards to employees, directors and consultants. Such awards include option grants, warrant grants, and restricted stock awards. During the nine months ended September 30, 2009, the Company had a negative stock compensation expense of approximately \$79,000 or \$0.01 per share (positive stock compensation expense of \$1,536,000- 2008 or (\$0.11) per share) as current-period stock based compensation expense was more than offset by reversals of previously recorded stock-based compensation expense for stock options and restricted shares issued to the Company's employees which terminated unvested due to employee terminations that occurred during the first nine months of 2009.

As of September 30, 2009, there was approximately \$313,000 of total unrecognized compensation costs (excluding the \$563,000 that vest upon the occurrence of certain events) related to non-vested options and restricted stock granted under the Company's stock option plans which the Company expects to vest over a period of not to exceed five years.

6. Impairment of Patent Defense Costs and Loss on Sale of Patent Assets Other Income

On March 19, 2008, the Company received notification that its appeal of the invalidation of its European Patent 455750B1 in the UK was not successful. As result of the adverse court decision, the Company recognized an impairment loss of \$292,000 associated with the U.K appeal as of March 31, 2008. The impairment loss includes a judgment for reimbursement of estimated counterpart legal fees. On July 31, 2009, the UK court made the final assessment of costs for the UK patent validity case due from the Company to the ECB of 356,490 pounds, of which the Company has paid \$332,000 pounds through September 30, 2009 and owes approximately 25,000 pounds (approximately \$40,000 as of September 30, 2009), which amount was included in accrued expenses as of September 30, 2009

On August 20, 2008, the Company entered into an agreement with Trebuchet Capital Partners, LLC (“Trebuchet”) under which Trebuchet has agreed to pay substantially all of the litigation costs associated with pending validity proceedings initiated by the European Central Bank (“ECB”) in eight European countries relating to the Company’s European Patent 0 455 750B1 that the Company has claimed the ECB infringed in printing of the Euro currency (the “Patent”). Trebuchet also agreed to pay substantially all of the litigation costs associated with future validity challenges filed by the ECB or other parties, provided that Trebuchet elects to assume the defense of any such challenges, in its sole discretion, and patent infringement suits filed against the ECB and certain other alleged infringers of the Patent, all of which suits may be brought at the sole discretion of Trebuchet and may be in the name of the Company, Trebuchet or both. The Company provided Trebuchet with the sole and exclusive right to manage infringement litigation relating to the Patent in Europe, including the right to initiate litigation in the name of the Company, Trebuchet or both and to choose whom and where to sue, subject to certain limitations set forth in the agreement. Under the terms of the Agreement, the Company and Trebuchet have agreed to equally share all proceeds generated from litigation relating to the Patent, including judgments and licenses or other arrangements entered into in settlement of any such litigation. Trebuchet is also entitled to recoup any litigation expenses specifically awarded to the Company in such actions. Under the terms of the Agreement, and in consideration for Trebuchet’s funding obligations, the Company assigned and transferred a 49% interest of the Company’s rights, title and interest in the Patent to Trebuchet which allows Trebuchet to have a separate and distinct interest in and share of the Patent, along with the right to sue and recover in litigation, settlement or otherwise to collect royalties or other payments under or on account of the Patent. Pursuant to this transaction, the Company recognized a loss on the sale of patent assets for its assignment and transfer of 49% of its ownership rights in the patent, which had a net book value of approximately \$1,670,000, for proceeds of \$500,000. As a result, the Company recognized a loss on sale of patent assets of \$1,170,000.

7. Other Income

On May 31, 2008, the Company was awarded a judgment of approximately \$126,000 pursuant to a positive judgment for the Company in its counterclaim in the matter “Frank LaLoggia v. Document Security Systems, Inc”, which the Company won in June 2006. The Company expects to collect the full amount of the judgment.

8. Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted earnings per share is computed by including the number of additional shares that would have been outstanding if dilutive potential shares had been issued. In periods of losses, diluted loss per share is computed on the same basis as basic loss per share as the inclusion of any other potential shares outstanding would be anti-dilutive. If the Company had generated earnings during the nine month period ended September 30, 2009, 235,665 (426,980 - 2008) common equivalent shares would have been added to the weighted average shares outstanding to compute the diluted weighted average shares outstanding.

9. Commitments and Contingencies

Legal Matters -On August 1, 2005, the Company commenced a suit against the European Central Bank (“ECB”) alleging patent infringement by the ECB and claimed unspecified damages. We brought the suit in the European Court of First Instance in Luxembourg. We alleged that all Euro banknotes in circulation infringe the Company European Patent 0 455 750B1 (the “Patent”), which covers a method of incorporating an anti-counterfeiting feature into banknotes or similar security documents to protect against forgeries by digital scanning and copying devices. The Court of First Instance ruled on September 5, 2007 that it does not have jurisdiction to rule on the patent infringement claim, and also ruled that we will be required to pay attorneys and court fees of the ECB. The ECB formally requested the Company to pay attorneys and court fees in the amount of Euro 93,752 (\$137,000 as of September 30, 2009), which, unless the amount is settled will be subject to an assessment procedure that will not likely be concluded until of the end of 2009 or first half of 2010, which the Company will accrue as soon as the assessed amount, if any, is reasonably estimatable.

On March 24, 2006, the Company received notice that the ECB had filed a separate claim in the United Kingdom and Luxembourg courts seeking the invalidation of the Patent. Proceedings were commenced before the national courts seeking revocation and declarations of invalidity of the Patent in each of the Netherlands, Belgium, Italy, France, Spain, Germany and Austria. On March 26, 2007, the High Court of Justice, Chancery Division, Patents Court in London, England (the "English Court") ruled that the Patent was deemed invalid in the United Kingdom, and on March 19, 2008 this decision was upheld on appeal. The English Court rejected the ECB's allegations of invalidity based on lack of novelty, lack of inventive step and insufficiency, but held that the patent was invalid for added subject matter. The English Court's decision does not affect the validity of the Patent in other European countries. As a result of these decisions, the Company was notified of the final assessment of the reimbursable ECB costs for both court cases was 356,490 pounds, of which the Company has paid \$332,000 pounds through September 30, 2009 and owes approximately 25,000 pounds (approximately \$40,000 as of September 30, 2009), which amount was included in accrued expenses as of September 30, 2009.

On March 27, 2007 the Bundespatentgericht of the Federal Republic of Germany ruled that the German part of the Patent was valid, having considered the English Court's decision. As a result of this ruling, the Company expects to be awarded reimbursements for its costs associated with the German validity case, which is Euro 44,692 (\$65,000 at September 30, 2009), which the Company will record when the amount, if any, is received. The ECB has filed an appeal against that decision, which is not expected to be decided before 2010. On January 9, 2008 the French Court held that the Patent was invalid in France for the same reasons given by the English Court. The Company is required to pay de minimus attorneys' fees of the ECB as a result of the French decision. The Company filed an appeal against the French decision on May 7, 2008. On March 12, 2008 the Dutch Court, having considered the English, German and French decisions, ruled that the Patent is valid in the Netherlands. The ECB filed an appeal against the Dutch decision on March 27, 2008. On November 3, 2009, the Belgium Court held that the Patent was invalid in Belgium for the same reasons given by the English and French courts. Costs reimbursements, if any, associated with the Belgium validity case are covered under the Trebuchet Agreement as described below. A trial was also held in Madrid, Spain on June 3 and 5, 2008 and oral and written closing submissions were made on July 19, 2008. A judgment is expected in the last quarter of 2009.

The Patent has thus been confirmed to be valid and enforceable in two jurisdictions (Germany and the Netherlands) that use the Euro as its national currency allowing the Company or Trebuchet Capital Partners, on the Company's behalf, to proceed with infringement cases in these countries if we choose to do so. Additional trials on the validity of the Patent are expected in other European jurisdictions during 2009.

On August 20, 2008, the Company entered into an agreement with Trebuchet Capital Partners, LLC ("Trebuchet") under which Trebuchet has agreed to pay substantially all of the litigation costs associated with pending validity proceedings initiated by the European Central Bank ("ECB") in eight European countries relating to the Company's European Patent 0 455 750B1 that the Company has claimed the ECB infringed in printing of the Euro currency (the "Patent"). Trebuchet also agreed to pay substantially all of the litigation costs associated with future validity challenges filed by the ECB or other parties, provided that Trebuchet elects to assume the defense of any such challenges, in its sole discretion, and patent infringement suits filed against the ECB and certain other alleged infringers of the Patent, all of which suits may be brought at the sole discretion of Trebuchet and may be in the name of the Company, Trebuchet or both. The Company provided Trebuchet with the sole and exclusive right to manage infringement litigation relating to the Patent in Europe, including the right to initiate litigation in the name of the Company, Trebuchet or both and to choose whom and where to sue, subject to certain limitations set forth in the agreement under the terms of the Agreement, and in consideration for Trebuchet's funding obligations, the Company assigned and transferred a 49% interest of the Company's rights, title and interest in the Patent to Trebuchet which allows Trebuchet to have a separate and distinct interest in and share of the Patent, along with the right to sue and recover in litigation, settlement or otherwise to collect royalties or other payments under or on account of the Patent. In addition, the Company and Trebuchet have agreed to equally share all proceeds generated from litigation relating to the Patent, including judgments and licenses or other arrangements entered into in settlement of any such litigation. Trebuchet is also entitled to recoup any litigation expenses specifically awarded to the Company in such actions.

On January 31, 2003, the Company commenced an action, unrelated to the above ECB litigation, entitled New Sky Communications, Inc., As Successor-In-Interest To Thomas M. Wicker, Thomas M. Wicker Enterprises, Inc. and Document Security Consultants V. Adler Technologies, Inc. N/K/A Adlertech International, Inc. and Andrew McTaggart (United States District Court, Western District Of New York Case No.03-Cv-6044t(F)) regarding certain intellectual property in which the Company has an interest. The Company commenced this action alleging various causes of action against Adler Technologies, Inc. and Andrew McTaggart for breach of contract, breach of the duty of good faith and fair dealing, various business torts, including unfair competition and declaratory relief. Adler distributes and supplies anti-counterfeit document products and Mr. McTaggart is a principal of Adler. Adler had entered into several purported agreements with Thomas M. Wicker Enterprises and Document Security Consultants, both of which the Company acquired in 2002. These alleged agreements, generally, would have authorized Adler to manufacture in Canada the Company's "Checkmate®" patented system for verifying the authenticity of currency and documents. Other purported agreements were signed between these parties and Thomas Wicker regarding other technology claimed to have been owned by Wicker and assigned to the Company. Among other things, the Company contends that certain of the purported agreements are not binding and/or enforceable. To the extent any of them are binding and enforceable, the Company claims that Adler has breached these purported agreements, failed to make an appropriate accounting and payments under them, and may have exceeded the scope of its license. Adler has denied the material allegations of the complaint and has counterclaimed against the Company, claiming Adler owns or co-owns or has a license to use certain of the Company's technologies. In May 2005, the Company filed a first amended and supplemental complaint adding Blanks/USA and Raymond Maxon as additional defendants. In February 2007, the Company filed a second amended and supplemental complaint adding Judith Wu (McTaggart's wife) and Arcis Digital Security, Inc. (a company in which Ms. Wu is involved) as additional defendants. Maxon has asserted a counterclaim against the Company contending that the Company's purported acquisition of a certain patent from Thomas Wicker in 2002 gave rise to an alleged right on the part of Maxon to receive a portion of Thomas Wicker's proceeds from such acquisition. The Company has denied the material allegations of all of the counterclaims. If Adler or Maxon is successful, or if a settlement is made, it may materially affect the Company, the Company's financial condition, and the Company's ability to market and sell certain of the Company technology and related products. This case is in discovery phase, and it is too soon to determine how the various issues raised by the lawsuit will be determined.

In addition to the foregoing, we are subject to other legal proceedings that have arisen in the ordinary course of business and have not been finally adjudicated. Although there can be no assurance in this regard, in the opinion of management, none of the legal proceedings to which we are a party, whether discussed herein or otherwise, will have a material adverse effect on our results of operations, cash flows or our financial condition.

Contingent Litigation Payment – In May 2005, the Company made an agreement with its legal counsel in charge of the Company's litigation with the European Central Bank which capped the fees for all matters associated with that litigation at \$500,000 plus expenses, and a \$150,000 contingent payment upon a successful ruling or settlement on the Company's behalf in that litigation. The Company will record the \$150,000 in the period in which the Company has determined that a successful ruling or settlement is probable.

In addition, pursuant to an agreement made in December 2004, the Company is required to share the economic benefit derived from settlements, licenses or subsequent business arrangements that the Company obtains from any infringer of patents formerly owned by the Wicker Family. For infringement matters involving certain U.S. patents, the Company will be required to disburse 30% of the settlement proceeds. For infringement matters involving certain foreign patents, the Company will be required to disburse 14% of the settlement proceeds. These payments do not apply to licenses or royalties to patents that the Company has developed or obtained from persons other than the Wicker Family. As of September 30, 2009, there have been no settlement amounts related to these agreements.

Contingent Purchase Price - In December, 2008, the Company acquired substantially all of the assets of DPI of Rochester, LLC ("DPI") in which the Company guaranteed up to \$50,000 to certain parties depending on whether certain conditions occurred within five years of the acquisition. As of September 30, 2009, the Company considers the likelihood that the payment will be required as remote.

Employment agreements - In May 2008, the Company entered into a Separation Agreement with its former President that, among other things, accelerated the vesting of 33,333 shares of restricted common stock of the Company that were previously awarded to the former President pursuant to the Company's 2004 Employee Stock Option Plan so that such shares vested in equal monthly installments during the immediately following ten months. The Separation Agreement further provided that if the former President did not realize at least \$212,000 in gross proceeds from the sale of such 33,333 shares of restricted stock upon their vesting, then the Company would pay the former President the amount that such proceeds is less than \$212,000 in cash or additional shares of common stock of the Company. As of June 30, 2009, all 33,333 shares had vested generating gross proceeds of approximately \$99,000. The Company has agreed to issue up to 30,000 shares of stock to pay the remaining amount due of \$113,000, of which 9,000 were issued during the quarter ended September 30, 2009. As of September 30, 2009, \$96,000 remains due under the agreement and is recorded in accrued expenses as of September 30, 2009. Any remaining amounts due under the agreement after the shares are issued, if any, can be paid in cash or additional shares.

Operating Leases - In March 2009, the Company, through its wholly-owned subsidiary DPI Secuprint, entered into two operating lease agreements for production equipment with Baum Capital Investments. The leases contain end of lease residual values that aggregate a total of \$800,000. Pursuant to these lease agreements, the Company is subject to certain conditions that place restrictions on the ability of DPI Secuprint to transfer cash or other assets to its parent, Document Security Systems, or other subsidiaries, during the lives of the leases. Total lease commitments associated with these leases as of September 30, 2009 are as follows:

2009	82,629
2010	422,131
2011	440,348
2012	394,419
2013	274,175
Thereafter	545,921
Total	<u>\$ 2,159,623</u>

10. Supplemental Cash Flow Information

During the nine months ended September 30, 2009, the Company entered into capitalized leases of approximately \$96,000 for production equipment at its commercial print facility. Cash paid for interest during the nine months ended September 30, 2009, was approximately \$153,000 (\$31,000 -2008). During the nine months ended September 30, 2008, the Company issued 19,260 shares for the payment of approximately \$94,000 of marketing expenses.

11. Segment Information

The Company's businesses are organized, managed and internally reported as four operating segments. Three of these operating segments, Document Security Systems, Plastic Printing Professionals, and DPI Secuprint, are engaged in various aspects of developing and applying printing technologies and procedures to produce, or allow others to produce, documents with a wide range of features, including the Company's patented technologies and trade secrets, along with traditional commercial printing on paper and plastic. For the purposes of providing segment information, these three operating segments have been aggregated into one reportable segment in accordance with ASC 280. A summary of the two segments follows:

Security and Commercial Printing

License, manufacture and sale of patented document security technologies, including digital security print solutions, and general commercial printing, primarily on paper and plastic. Comprises the operations of Document Security Systems, Plastic Printing Professionals, and DPI Secuprint, which the Company acquired on December 18, 2008.

Legal Supplies

Sale of specialty legal supplies, primarily to lawyers and law firms located throughout the United States as Legalstore.com. During the fourth quarter of 2009, the Company sold its legal products business. In accordance with FASB ASC 360-10-45-9 guidance for long-lived assets, the Company accounts for the assets and certain liabilities as held for sale as of September 30, 2009. In accordance with ASC 205-20-45, the Company continues to report the results of operations for Legalstore.com as continued operations given the Company's continued involvement after the sale.

Approximate information concerning the Company's operations by reportable segment for the three and nine months ended September 30, 2009 and 2008 is as follows. The Company relies on intersegment cooperation and management does not represent that these segments, if operated independently, would report the results contained herein:

3 months ended September 30, 2009:	Legal Supplies	Security and Commercial Printing	Corporate	Total
Revenues from external customers	\$ 102,000	\$ 2,451,000	\$ -	\$ 2,553,000
Depreciation and amortization	5,000	395,000	1,000	401,000
Segment profit (loss)	10,000	(505,000)	(460,000)	(955,000)

3 months ended September 30, 2008:

Revenues from external customers	\$ 151,000	\$ 1,523,000	\$ -	\$ 1,674,000
Depreciation and amortization	4,000	615,000	1,000	620,000
Segment profit (loss)	(6,000)	(2,046,000)	(611,000)	(2,663,000)

9 months ended September 30, 2009:	Legal Supplies	Security and Commercial Printing	Corporate	Total
Revenues from external customers	\$ 355,000	\$ 7,224,000	\$ -	\$ 7,579,000
Depreciation and amortization	15,000	1,203,000	3,000	1,221,000
Segment profit (loss)	37,000	(1,610,000)	(1,300,000)	(2,873,000)

9 months ended September 30, 2008:

Revenues from external customers	\$ 483,000	\$ 4,847,000	\$ -	\$ 5,330,000
Depreciation and amortization	12,000	1,827,000	3,000	1,842,000
Segment profit (loss)	29,000	(4,293,000)	(1,918,000)	(6,182,000)

12. Assets and Liabilities Held For Sale

As of September 30, 2009, the Company has classified the assets and liabilities of Legalstore.com, reported in the “Legal Supplies” segment, as held for sale. The Company signed an asset purchase agreement on October 8, 2009 to sell various assets and liabilities of Legalstore.com in exchange for common stock of Internet Media Services, Inc (See Note 13). The Company expects to record the asset sale at fair market value on the date of sale based on the estimated fair market value the Company calculated utilizing a discounted cash flow projection model. The Company has not yet determined the amount of any gain or the timing for recognition from the sale. The assets and liabilities of Legalstore.com have been reported as long-term in the accompanying balance sheet as of September 30, 2009 because they are not expected to be realized in the normal operating cycle as a result of the receipt of an equity method investment as proceeds for the sale. The assets and liabilities of Legalstore.com included in the sale are as follows:

Cash	18,186
Accounts receivable	31,434
Inventory	92,521
Fixed Assets	32,218
Goodwill	81,013
Assets	255,372
AP	18,563
Accrued liabilities	5,473
Liabilities	24,036
Net	231,336

13. Subsequent Events

On October 8, 2009, Lester Levin Inc., ("LLI") a wholly owned subsidiary of the Company entered into an Asset Purchase Agreement with Internet Media Services, Inc., ("IMS"), whereby LLI agreed to sell the assets associated with its LegalStore.Com business ("LegalStore") to IMS (the "Asset Purchase Agreement").

In consideration of the sale and transfer of the LegalStore assets, IMS agreed to issue 7,500,000 shares of common stock, par value \$.001 per share, of IMS to the Company. Pursuant to the Asset Purchase Agreement and related agreements, IMS agreed to file a registration statement on Form S-1, within 180 days of closing, with respect to the IMS Common Stock.

On October 8, 2009, the transactions contemplated by the Asset Purchase Agreement were closed and in accordance therewith LLI sold the Acquired Assets to IMS in exchange for the IMS Common Stock issued to the Company (the "Transaction").

On October 19, 2009, the Company completed the sale of 17.6 investment units in a private placement pursuant to subscription agreements with three accredited investors dated the same date. Each investment unit is comprised of 6,250 shares of the Company's common stock and five year warrants to purchase 1,250 shares of common stock at an exercise price of \$2.00 per share. In the transaction, the Company sold 17.6 investment units for \$10,000 per unit for gross cash proceeds of \$176,000, consisting of 110,000 shares of common stock and warrants to purchase an aggregate of 22,000 shares of common stock.

On October 21, 2009, the Company entered to a Consulting Agreement with Vertical Innovation, Inc. ("Vertical Innovation"), a related party to Internet Media Services, Inc., for internet related consulting services (the "Consulting Agreement"). The Consulting Agreement provides that Vertical Innovation will provide consulting services upon request during the term of the agreement related to Internet development and strategy. The Consulting Agreement is for a two year term unless earlier terminated by the Company for cause, as defined in the Consulting Agreement. The compensation to be paid to Vertical Innovation under the Consulting Agreement is in the form of warrants to purchase 50,000 shares of the Company's common stock at \$3.00, 100,000 shares of common stock at \$3.50 and 50,000 shares of common stock at \$4.00. Issuance of the Warrants is subject to NYSE Amex approval under an additional listing application. The Company initially valued these warrants at approximately \$260,000 using the Black-Scholes option pricing model which the Company expects to record as expense over a two year period. The actual expense associated with these warrants will be based on the measurement date, the vesting is contingent on certain performance conditions.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

Certain statements contained herein constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995 (the “1995 Reform Act”). Document Security Systems, Inc. desires to avail itself of certain “safe harbor” provisions of the 1995 Reform Act and is therefore including this special note to enable us to do so. Except for the historical information contained herein, this report contains forward-looking statements (identified by the words "estimate," "project," "anticipate," "plan," "expect," "intend," "believe," "hope," "strategy" and similar expressions), which are based on our current expectations and speak only as of the date made. These forward-looking statements are subject to various risks, uncertainties and factors that could cause actual results to differ materially from the results anticipated in the forward-looking statements, including, without limitation, those contained in our Form 10-K for the year ended December 31, 2008, and those described herein that could cause actual results to differ materially from the results anticipated in the forward-looking statements, and the following:

- Our limited operating history with our business model
- Our ability to pay or renegotiate three secured credit facilities that have large principal payments due in December 2009 and January 2010
- Our low cash balance and limited financing currently available to us, we may in the near future have a number of obligations that we will be unable to meet without generating additional income or raising additional capital.
- The risk of insolvency or bankruptcy if we cannot generate additional income or raise additional capital in the near future
- Further cost reductions or curtailment in future operations due to our low cash balance and negative cash flow
- Our ability to effect a financing transaction to fund our operations could adversely affect the value of your stock.
- Our limited cash resources may not be sufficient to fund continuing losses from operations and the expenses of the current patent validity and patent infringement litigations.
- The loss in current litigation in which we may lose certain of our technology rights, which may affect our business plan.
- The inability to adequately protect our intellectual property
- Intellectual property infringement or other claims against us, our customers or our intellectual property that could be costly to defend and result in our loss of significant rights.
- The failure of our products and services to achieve market acceptance
- Changes in document security technology and standards could render our applications and services obsolete.
- The inability to compete in our market, especially against established industry competitors with greater market presence and financial resources.
- The inability to meet our growth strategy of acquiring complementary businesses and assets and expanding our existing operations to include manufacturing capabilities.

Overview

Document Security Systems, Inc. (referred to in this report as “Document Security,” “we,” “us,” “our” or “Company”) markets, produces and sells products designed to protect valuable information from unauthorized scanning, copying, and digital imaging. We develop sophisticated security technologies that are applied during the normal printing process and by virtually all printing methods including traditional offset, gravure, flexo, digital or via the Internet on paper, plastic, or packaging. We believe we are a leader of customized document protection solutions for companies and governments worldwide. We hold eight patents that protect our technology and have over a dozen patents in process or pending. Our technologies and products are used by federal, state

and local governments, law enforcement agencies and are also applied by a broad variety of industries, including financial institutions, high technology and consumer goods, entertainment and gaming, healthcare/pharmaceutical, defense and genuine parts industries. Our customers use our technologies where there is a need for enhanced security for protection and verification of critical financial instruments and vital records, or where there are concerns of counterfeiting, fraud, identity theft, brand protection and liability.

Our core business is counterfeit prevention, brand protection and validation of authentic print media, including government-issued documents, currency, private corporate record and, securities. We believe we are a world leader in the research and development of optical deterrent technologies and have commercialized these technologies with a broad suite of products that offer our customers a wide array of document security solutions to satisfy their specific anti-counterfeiting requirements. Our technology can be used in securing sensitive and critical documents such as currency, automobile titles, spare parts forms for the aerospace industry, gift certificates, permits, checks, licenses, receipts, prescription and medical forms, engineering schematics, ID cards, labels, original music, coupons, homeland security manuals, consumer product and pharmaceutical packaging, tickets, and school transcripts. In addition, we have developed a digital product to implement our technologies in Internet-based environments utilizing standard desktop printers. We believe that our digital technology greatly expands the reach and potential market for our technologies and solutions. In December 2008, we acquired substantially all of the assets of DPI of Rochester, LLC, a privately held commercial printer located in Rochester, NY with approximately \$7.6 million in sales in 2007. We formed a new subsidiary called DPI Secuprint to house this new company. As a result of this acquisition, we have significantly improved our ability to meet our current and expected future demand of our security paper products as well as improving our competitiveness in the market for custom security printing, especially in the areas of vital records, coupons, transcripts, and prescription paper. In addition, as a result of the acquisition, we believe we can offer our customers a wider range of commercial printing offerings.

Technologies

We have developed or acquired over 30 technologies that provide our customers a wide spectrum of solutions. Our primary anti-counterfeiting products and technologies are marketed under the AuthentiGuard trade names.

Products and Services

Generic Security Paper: Our primary product for the retail end-user market is AuthentiGuard® Security Paper. AuthentiGuard® Security Paper is blank paper that contains our Pantograph 4000™ technology. The paper reveals hidden warning words, logos or images using The Authenticator- our proprietary viewing lens –when the paper is faxed, copied or scanned. The hidden words appear on the duplicate or the computer digital file and essentially prevent documents, including forms, coupons and tickets, from being counterfeited. We market and sell our AuthentiGuard® Security Paper primarily through one major paper distributor: Boise. Since 2005, Boise has marketed our AuthentiGuard® Security Paper under its Boise Beware brand name in North America, primarily through its commercial paper sales group. We retain the rights to sell the AuthentiGuard® Security Paper directly to end-users anywhere in the world.

Security and Commercial Printing: Our technology portfolio allows us to create unique custom secure paper, plastic, packaging and Internet-based and software enterprise solutions. We market and sell to end-users that require anti-counterfeiting and authentication features in a wide range of printed materials such as documents, vital records, prescription paper, driver's licenses, birth certificates, receipts, manuals, identification materials, entertainment tickets, coupons, parts tracking forms, as well as product packaging including pharmaceutical and a wide range of consumer goods. In addition, we provide a full range of digital and large offset commercial printing capabilities to our customers.

Since our inception, we have primarily outsourced the production of the majority of our custom security print orders to strategic printing vendors. In December 2008, we acquired a commercial printer with long-run offset and short run digital printing capabilities that will allow us to produce the majority of our security print orders in-house. As a result of this acquisition, we have significantly improved our ability to meet our current and expected future demand of our security paper products as well as improving our competitiveness in the market for custom security printing, especially in the areas of vital records, coupons, transcripts, and prescription paper. We produce our plastic printed documents such as ID cards, event badges, and driver licenses at our manufacturing facility in Brisbane, California under the name Plastic Printing Professionals. Our P3 manufacturing facility is 25,000 square foot and during 2008, we upgraded their production capabilities by adding equipment that will improve its productivity, along with equipment for high speed data encoding and equipment for production of high-volume precision RFID cards.

Digital Security Solutions: Using software that we have developed, we can electronically render several of our technologies digitally to extend the use of optical security to the end-user of sensitive information. With our AuthentiGuard™ DX we market a networked appliance that allows the author of any Microsoft Office document (Outlook, Word, Excel, or PowerPoint) to secure nearly any of its alphanumeric content when it is printed or digitally stored. AuthentiGuard® DX prints selected content using DMC'S patented technology so that it cannot be read by the naked eye. Reading the hidden content, or authenticating the document is performed with a proprietary viewing device or software.

Technology Licensing: We license our anti-counterfeiting technology and trade secrets to security printers through licensing arrangements. We seek licensees that have a broad customer base that can benefit from our technologies or have unique and strategic capabilities that expand the capabilities that we can offer our potential customers. Licenses can be for a single technology or for a package of technologies. We offer licensees a variety of pricing models, including:

- Pay us one price per year;
- Pay us a percentage of gross sales price of the product containing the technology during the term; or
- Joint venture or profit sharing arrangement.

Legal Products: We also own and operate Legalstore.com, an Internet company which sells legal supplies and documents, including security paper and products for the users of legal documents and supplies in the legal, medical and educational fields. On October 8, 2009 we sold the assets and certain liabilities associated with our LegalStore.Com business to Internet Media Services.

Results of Operations for the Three and Nine Months Ended September 30, 2009 Compared to the Three and Nine Months ended September 30, 2008

The following discussion and analysis provides information that our management believes is relevant to an assessment and understanding of our results of operations and financial condition. During the fourth quarter of 2009, the Company finalized an agreement to sell its legal products business. In accordance with ASC 205-20-45, as a result of the significant continued involvement of the Company after the sale, the Company continues to account for the revenue and expenses of this operation as continued operations.

The discussion should be read in conjunction with the financial statements and footnotes in this quarterly report and in our annual report on Form 10-K for the year ended December 31, 2008.

Revenue

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	% change	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008	% change
<i>Revenue</i>						
Security and commercial printing	\$ 2,247,000	\$ 1,334,000	68%	\$ 6,605,000	\$ 3,421,000	93%
Technology license royalties and digital solutions	204,000	189,000	8%	619,000	1,427,000	-57%
Legal products	102,000	150,000	-32%	355,000	483,000	-27%
<i>Total Revenue</i>	2,553,000	1,673,000	53%	7,579,000	5,331,000	42%

For the three months ended September 30, 2009, revenue increased 53% from the same period in 2008. Security and commercial print sales increased 68% during the quarter which reflects the impact of the Company's acquisition of DPI Secuprint, a commercial printer, in December, 2008. This increase was slightly offset by a decrease in revenue from the Company's legal products division, Legalstore.com, which the Company sold in October of 2009.

For the nine months ended September 30, 2009, revenue increased 42% from the first nine months of 2008, due to the Company's acquisition of its commercial printing business in December 2008, which more than offset the 57% decline in technology license royalties and digital solutions revenue as a result of a non-recurring royalty of \$542,000 recorded in the second quarter of 2008 that affected the comparison. During 2009, all of the Company's divisions were adversely affected by significant delays or reductions in orders by core customers that reflected the rapid decline in the U.S. and global economies during the latter half of 2008 and the first half of 2009. The Company began to see demand in each of divisions to return to more traditional levels in the third quarter of 2009 and expects this trend to continue as the U.S. and global economies stabilize.

Cost of Sales and Gross Profit

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	% change	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008	% change
<i>Costs of revenue</i>						
Security and commercial printing	\$ 1,516,000	\$ 636,000	138%	\$ 4,547,000	\$ 2,028,000	124%
Technology license royalties and digital solutions	4,000	4,000	0%	11,000	11,000	0%
Legal products	56,000	86,000	-35%	179,000	258,000	-31%
<i>Total cost of revenue</i>	1,576,000	726,000	117%	4,737,000	2,297,000	106%

<i>Gross profit</i>						
Security and commercial printing	731,000	698,000	5%	2,058,000	1,393,000	48%
Technology license royalties and digital solutions	200,000	185,000	8%	608,000	1,416,000	-57%
Legal products	46,000	64,000	-28%	176,000	225,000	-22%
<i>Total gross profit</i>	977,000	947,000	3%	2,842,000	3,034,000	-6%

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	% change	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008	% change
Gross profit percentage:	38%	57%	-33%	37%	57%	-35%

Gross profit increased 3% to \$977,000 in the third quarter of 2009 as compared to the third quarter of 2008. The increase was due to the increase in sales, but was minimized by the increase in the amount of commercial printing revenue as a percentage of total due to the Company's acquisition of DPI Secuprint, a commercial printer, in December, 2008. Commercial printing typically carries lower margins than the Company's security printing projects. In addition, the Company has increased the fixed cost component of its cost of sales as a result of investments in equipment at the Company's plastic printing facility which has significantly increased production capacity. While these investments lower the Company's gross profits at its traditional revenue levels, they will allow the Company to significantly increase its revenue potential at the facility at traditional margins.

Operating Expenses

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	% change	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008	% change
<i>Operating Expenses</i>						

Sales, general and administrative compensation	\$	855,000	\$	539,000	59%	\$	2,713,000	\$	1,622,000	67%
Professional Fees		147,000		206,000	-29%		434,000		780,000	-44%
Sales and marketing		34,000		204,000	-83%		105,000		892,000	-88%
Research and development		61,000		73,000	-16%		223,000		322,000	-31%
Rent and utilities		129,000		122,000	6%		399,000		322,000	24%
Other		197,000		197,000	0%		452,000		580,000	-22%
	\$	1,423,000	\$	1,341,000	6%	\$	4,326,000	\$	4,518,000	-4%

Other Operating Expenses

Depreciation and amortization		36,000		42,000	-14%		116,000		126,000	-8%
Stock based payments		38,000		480,000	-92%		(79,000)		1,506,000	-105%
Impairment of patent defense costs		-		-			-		292,000	-100%
Amortization of intangibles		324,000		541,000	-40%		971,000		1,605,000	-40%
		398,000		1,063,000	-63%		1,008,000		3,529,000	-71%

<i>Total Operating Expenses</i>		1,821,000		2,404,000	-24%		5,334,000		8,047,000	-34%
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Selling, General and Administrative

Sales, general and administrative compensation costs were 59% and 67% higher in the three and nine months ending September, 30, 2009, respectively, as compared to the comparable 2008 periods, due to the inclusion of sales and administrative staff additions as the result of the Company's acquisition of its commercial printing business in December 2008. Otherwise, SG&A compensation costs would have decreased 32% and 27% during the three and nine months ended September 30, 2009, respectively, as compared to the comparable 2008 periods, as the result of staff reductions that the Company initiated in the middle of 2008 and during the first quarter of 2009.

Professional fees decreased in 29% third quarter of 2009 from the third quarter of 2008 primarily as a result of a significant decrease in consulting fees of approximately \$80,000 due to cost cuts initiated by the Company in 2008. This decrease was offset by an increase of approximately \$40,000 in legal fees incurred by the Company during the three months ended September 30, 2009 as compared to the three months ended September 30, 2008.

Sales and marketing expenses decreased significantly in the third quarter and first nine months of 2009 as compared to 2008 as the Company has changed its primary sales and marketing strategy resulting in a reduction in its non-direct marketing costs, its international sales cost, and an overall reduction in sales related travel. The Company has recently focused its efforts on direct sales techniques that utilize telephone and web-conferencing communication with current and prospective customers, along with increasing its internet presence focused on the Company's primary e-commerce website www.protectedpaper.com. The Company expects to see increases in its sales and marketing expenses in the remainder of 2009 and in 2010 as general economic conditions improve.

Research and development costs consist primarily of compensation costs for research personnel and direct costs for the use of third-party printers' facilities to test our technologies on equipment that we do not have access to internally. Research and development costs decreased during the 2009 periods as compared to the comparable 2008 periods as the result of lower external research costs and reduction in compensation cost as the Company reduced the department by 2 persons.

Rent and utilities costs have increased in 2009 over 2008 as a result of the Company's acquisition of its commercial printing business in December 2008, which operates a 20,000 square foot facility in Rochester, NY.

Other operating expenses are primarily equipment maintenance and repairs, office supplies, IT support, bad debt expense and insurance costs. On a consolidated basis, these costs were flat in the third quarter of 2009 as compared to the third quarter of 2008, despite the addition of other expenses associated with the Company's acquisition of DPI Secuprint in in December 2008.

Stock-based compensation includes expense charges for all stock-based awards to employees, directors and consultants. Such awards include option grants, warrant grants, and restricted stock awards. Stock-based compensation decreased during the three and nine month periods ended September 30, 2009 as compared to the comparable 2008 periods, as current-period stock based compensation expense was more than offset by reversals of previously recorded stock-based compensation expense for stock options and restricted shares issued to the Company's employees which terminated unvested due to employee terminations that occurred during 2009.

Impairment of Patent Defense Costs On March 19, 2008, the Company received notification that its appeal of the invalidation of its European Patent 455750B1 in the UK was not successful. As result of the adverse court decision, the Company recognized an impairment loss of \$292,000 associated with the U.K appeal as of March 31, 2008. The impairment loss includes a judgment for reimbursement of estimated counterpart legal fees. No such expense was incurred in 2009.

Amortization of intangibles expense decreased 40% in the three and nine months ended September 30, 2009, as compared to the 2008 periods as a result of the reduction in the Company's net capitalized patent acquisition and defense costs asset from \$2.3 million as of September 30, 2008 to \$1.1 million as of September 30, 2009. The reduction in the Company's patent acquisition and defense costs was primarily due to the Company's transfer and assignment of 49% of its interest in the patent to a third-party in August 2008, which resulted in a reduction in the asset of approximately \$1.7 million.

Other Income and expenses

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	% change	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008	% change
Other income (expense):						
Gain/(Loss) on foreign currency adjustments	(1,000)	8,000	-113%	10,000	(17,000)	-159%
Interest Income	18,000	-		18,000	-	
Interest expense	(58,000)	(41,000)	41%	(207,000)	(95,000)	118%
Loss on sale of patent assets	-	(1,170,000)		-	(1,170,000)	
Amortization of note discount	(64,000)	-		(189,000)	-	
Other income	-	-		-	126,000	
Other income (expense), net	(105,000)	(1,203,000)	-91%	(368,000)	(1,156,000)	-68%

During the first nine months of 2009, the Company had significant increases in interest expense over the comparable period in 2008 as a result of the Company's borrowings it made during 2008 against its various credit facilities and for interest associated with a \$900,000 Secured Promissory Note which the Company used to acquire its commercial printing business in December of 2008. As of September 30, 2009, the Company had \$3.0 million outstanding under its revolving notes at an interest rate of LIBOR plus 2%, which was approximately 3.27% as of September 30, 2009, and \$900,000 was outstanding under the Secured Promissory Note which had an annual interest rate of 12%.

During the first nine months of 2009, the Company also recognized amortization of note discount expense of approximately \$189,000 for warrants that were issued in conjunction with the secured promissory note which had a fair value of approximately \$256,000 and will be amortized over the term of the note. In 2008, the Company was awarded a judgment of approximately \$126,000 pursuant to a counterclaim by the Company in the matter "Frank LaLoggia v. Document Security Systems, Inc", which the Company won in June 2006. Also in 2008, the Company entered into an agreement with Trebuchet Capital Partners, LLC Pursuant to the Agreement, Trebuchet has agreed to pay substantially all of the litigation costs associated with pending validity proceedings initiated by the European Central Bank in eight European countries relating to the Company's European Patent 0 455 750B1 that the Company has claimed the ECB infringed in printing of the Euro currency. Under the terms of the Agreement, and in consideration for Trebuchet's funding obligations, the Company assigned and transferred a 49% interest of the Company's rights, title and interest in the Patent to Trebuchet which allows Trebuchet to have as a separate and exclusive interest including a separate and distinct right to exploit the Patent. Pursuant to this transaction, the Company recognized a loss on the sale of patent assets for its assignment and transfer of 49% of its ownership rights in the patent, which had a net book value of approximately \$1,670,000, for \$500,000. As a result, the Company recognized a loss on sale of patent assets of \$1,170,000.

Net Loss and Loss Per Share

	Three Months Ended June 30, 2009	Three Months Ended September 30, 2008	% change	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008	% change
Net loss	\$ (955,000)	\$ (2,663,000)	-64%	\$ (2,873,000)	\$ (6,182,000)	-54%
Net loss per share, basic and diluted	\$ (0.06)	\$ (0.19)	-68%	\$ (0.20)	\$ (0.45)	-56%
Weighted	14,711,105	14,286,192	3%	14,510,056	13,879,891	5%

average
common
shares
outstanding,
basic and
diluted

During the third quarter of 2009, the Company experienced a net loss of \$954,000, a 64% decrease from the net loss of the third quarter of 2008. The decrease in net loss during the quarter was primarily the result of the significant decrease in other operating costs, along with the absence of a non-recurring loss on sale of patent which the Company incurred in the third quarter of 2008. For the first nine months of 2009, the Company's net loss decreased 54% from the comparable period in 2008 primarily due to the significant decrease in the Company's other operating expenses in 2009, which more than offset increases in interest expense and amortization of note discount associated with the increase in debt incurred by the Company in the latter half of 2008 and during the first nine months of 2009.

LIQUIDITY AND CAPITAL RESOURCES

The Company's cash flows and other key indicators of liquidity are summarized as follows:

	As Of And For The Period Ended:		
	September 30, 2009	September 30, 2008	% change vs. 2008
Cash flows from:			
Operating activities	\$ (1,484,000)	\$ (2,116,000)	30%
Investing activities	(71,000)	(871,000)	92%
Financing activities	1,890,000	2,688,000	30%
Working capital	(4,561,000)	(836,000)	446%
Current ratio	0.32x	0.68x	-53%
Cash and cash equivalents	\$ 423,000	\$ 443,000	-5%
Short Term Debt	\$ 3,933,000	\$ 1,858,000	112%
Funds Available from Open Credit Facilities	\$ 567,000	\$ 1,742,000	-67%

As of September 30, 2009, our cash balance was approximately \$423,000, up from \$88,000 at December 31, 2008. The increase in cash was due to the receipt of funds from borrowings from Company's credit facilities along with cash proceeds from the sale of the Company's equity. During the first nine months of 2009, the Company used \$1.5 million of cash for operations and \$71,000 for investments in long-lived assets. These amounts were significantly lower than comparable 2008 levels which reflects the improvement of the Company's operating results, including the positive impact on operating cash flows from the Company's acquisition of its commercial printing business in December 2008. In addition, in 2009, the Company essentially eliminated cash outflows associated with the Company's patent litigation efforts as a result of its litigation agreement in August 2008 with Trebuchet Capital Partners.

Future Capital Needs As of September 30, 2009, our cash balance was approximately \$423,000, and our current liabilities totaled approximately \$6,688,000, which includes \$3,033,000 of short term debt under two credit facilities that are due on January 2, 2010, and a \$900,000 Secured Promissory Note due on December 19, 2009. During 2009, we raised approximately \$1.2 million, net of expenses, through the private placement of our common stock and warrants. The Company has and will use these funds to fund its operating cash flow requirements. In order to meet our operating needs and these current obligations, we will need to generate additional income from operations or obtain additional financing, including without limitation, fund-raising through additional sales of equity. We also need to negotiate with our lenders to extend or refinance our existing credit facilities. Additionally, our ability to utilize cash generated by our DPI Secuprint subsidiary for corporate obligations is restricted by the terms of certain of its third party equipment operating leases, which could negatively affect our ability to raise cash from other sources, or to satisfy our obligations. The Company expects to be able to sell its common stock in order to meet its future capital needs, but there is no guarantee that the Company will be able to do so.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have, or are reasonably likely to have, an effect on our financial condition, financial statements, revenues or expenses.

Critical Accounting Policies and Estimates

As of September 30, 2009, our critical accounting policies and estimates have not changed materially from those set forth in our Annual Report on Form 10-K for the year ended December 31, 2008.

ITEM 4T - CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Management is responsible for establishing and maintaining effective disclosure controls and procedures. Our Chief Executive Officer and Chief Financial Officer participated with our management in evaluating the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and that such information is accumulated and communicated to management, including the CEO and the CFO, as appropriate, to allow timely decisions regarding required disclosure.

Based on this evaluation, and in light of the material weaknesses in our internal control over financial reporting that are discussed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 these officers have concluded that our disclosure controls and procedures were not effective. The material weaknesses consist of an insufficient complement of qualified accounting personnel and controls associated with segregation of duties and ineffective controls associated with identifying and accounting for complex and non-routine transactions in accordance with U.S. generally accepted accounting principles. To address the material weaknesses we performed additional analyses and other post-closing procedures to ensure our consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). Notwithstanding these material weaknesses, management believes that the financial statements included in this Quarterly Report on Form 10-Q fairly present, in all material respects, our financial condition, result of operations and cash flows for the periods presented.

There can be no assurance, however, that our disclosure controls and procedures will detect or uncover all failures of persons within the Company and its consolidated subsidiaries to disclose material information otherwise required to be set forth in our periodic reports. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable, not absolute, assurance of achieving their control objectives.

Changes in Internal Control Over Financial Reporting

During the first nine months of 2009, the Company incorporated the accounting staff from its acquisition of a commercial printer in December 2008 into its financial reporting process and will seek to use these new resources to improve its areas of deficiency in the financial reporting process. The Company will evaluate the effect of its changes in internal controls during its annual assessment of its internal controls as of December 31, 2009. Additionally, as described above under "Controls And Procedures - Evaluation of Disclosure Controls and Procedures," we also began implementing additional procedures to address the material weaknesses identified in our internal controls over financial reporting.

An evaluation was performed under the supervision of the Company's management, including the CEO and CFO, as required under Exchange Act Rule 13a-15(d) and 15d-15(d), of whether any change in the Company's internal control over financial reporting occurred during the fiscal quarter ended September 30, 2009. Based on that evaluation, the Company's management, including the CEO and CFO, concluded that, other than the changes discussed above, no other changes in our internal control over financial reporting occurred during the first nine months of 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1 - LEGAL PROCEEDINGS

Information concerning pending legal proceedings is incorporated herein by reference to Note 8 to the Condensed Consolidated Financial Statements (Unaudited) in Part I of this Form 10-Q.

On August 1, 2005, we commenced a suit against the European Central Bank (“ECB”) alleging patent infringement by the ECB and claimed unspecified damages. We brought the suit in the European Court of First Instance in Luxembourg. We alleged that all Euro banknotes in circulation infringe the Company European Patent 0 455 750B1 (the “Patent”), which covers a method of incorporating an anti-counterfeiting feature into banknotes or similar security documents to protect against forgeries by digital scanning and copying devices. The Court of First Instance ruled on September 5, 2007 that it does not have jurisdiction to rule on the patent infringement claim, and also ruled that we will be required to pay attorneys and court fees of the ECB. The ECB formally requested the Company to pay attorneys and court fees in the amount of Euro 93,752 (\$137,000 as of September 30, 2009), which, unless the amount is settled will be subject to an assessment procedure that will not likely be concluded until of the end of 2009 or first half of 2010, which the Company will accrue as soon as the assessed amount, if any, is reasonably estimatable.

On March 24, 2006, the Company received notice that the ECB had filed a separate claim in the United Kingdom and Luxembourg courts seeking the invalidation of the Patent. Proceedings were commenced before the national courts seeking revocation and declarations of invalidity of the Patent in each of the Netherlands, Belgium, Italy, France, Spain, Germany and Austria. On March 26, 2007, the High Court of Justice, Chancery Division, Patents Court in London, England (the “English Court”) ruled that the Patent was deemed invalid in the United Kingdom, and on March 19, 2008 this decision was upheld on appeal. The English Court rejected the ECB’s allegations of invalidity based on lack of novelty, lack of inventive step and insufficiency, but held that the patent was invalid for added subject matter. The English Court’s decision does not affect the validity of the Patent in other European countries. As a result of these decisions, the Company was notified of the final assessment of the reimbursable ECB costs for both court cases was 356,490 pounds, of which the Company has paid \$332,000 pounds through September 30, 2009 and owes approximately 25,000 pounds (approximately \$40,000 as of September 30, 2009), which amount was included in accrued expenses as of September 30, 2009

On March 27, 2007 the Bundespatentgericht of the Federal Republic of Germany ruled that the German part of the Patent was valid, having considered the English Court’s decision. As a result of this ruling, the Company expects to be awarded reimbursements for its costs associated with the German validity case, which is Euro 44,692 (\$65,000 at September 30, 2009), which the Company will record when the amount, if any, is received. The ECB has filed an appeal against that decision, which is not expected to be decided before 2010. On January 9, 2008 the French Court held that the Patent was invalid in France for the same reasons given by the English Court. The Company is required to pay de minimus attorneys’ fees of the ECB as a result of the French decision. The Company filed an appeal against the French decision on May 7, 2008. On March 12, 2008 the Dutch Court, having considered the English, German and French decisions, ruled that the Patent is valid in the Netherlands. The ECB filed an appeal against the Dutch decision on March 27, 2008. On November 3, 2009, the Belgium Court held that the Patent was invalid in Belgium for the same reasons given by the English and French courts. Costs reimbursements, if any, associated with the Belgium validity case are covered under the Trebuchet Agreement as described below. A trial was also held in Madrid, Spain on June 3 and 5, 2008 and oral and written closing submissions were made on July 19, 2008. A judgment is expected in the last quarter of 2009.

The Patent has thus been confirmed to be valid and enforceable in two jurisdictions (Germany and the Netherlands) that use the Euro as its national currency allowing the Company or Trebuchet Capital Partners, on the Company’s behalf, to proceed with infringement cases in these countries if we choose to do so. Additional trials on the validity of the Patent are expected in other European jurisdictions during 2009.

On August 20, 2008, the Company entered into an agreement with Trebuchet Capital Partners, LLC (“Trebuchet”) under which Trebuchet has agreed to pay substantially all of the litigation costs associated with pending validity proceedings initiated by the European Central Bank (“ECB”) in eight European countries relating to the Company’s European Patent 0 455 750B1 that the Company has claimed the ECB infringed in printing of the Euro currency (the “Patent”). Trebuchet also agreed to pay substantially all of the litigation costs associated with future validity challenges filed by the ECB or other parties, provided that Trebuchet elects to assume the defense of any such challenges, in its sole discretion, and patent infringement suits filed against the ECB and certain other alleged infringers of the Patent, all of which suits may be brought at the sole discretion of Trebuchet and may be in the name of the Company, Trebuchet or both. The Company provided Trebuchet with the sole and exclusive right to manage infringement litigation relating to the Patent in Europe, including the right to initiate litigation in the name of the Company, Trebuchet or both and to choose whom and where to sue, subject to certain limitations set forth in the agreement under the terms of the Agreement, and in consideration for the Trebuchet's funding obligations, the Company assigned and transferred a 49% interest of the Company's rights, title and interest in the Patent to Trebuchet which allows Trebuchet to have a separate and distinct interest in and share of the Patent, along with the right to sue and recover in litigation, settlement or otherwise to collect royalties or other payments under or on account of the Patent. In addition, the Company and Trebuchet have agreed to equally share all proceeds generated from litigation relating to the Patent, including judgments and licenses or other arrangements entered into in settlement of any such litigation. Trebuchet is also entitled to recoup any litigation expenses specifically awarded to the Company in such actions.

On January 31, 2003, the Company commenced an action, unrelated to the above ECB litigation, entitled New Sky Communications, Inc., As Successor-In-Interest To Thomas M. Wicker, Thomas M. Wicker Enterprises, Inc. and Document Security Consultants V. Adler Technologies, Inc. N/K/A Adlertech International, Inc. and Andrew McTaggart (United States District Court, Western District Of New York Case No.03-Cv-6044t(F)) regarding certain intellectual property in which the Company has an interest. The Company commenced this action alleging various causes of action against Adler Technologies, Inc. and Andrew McTaggart for breach of contract, breach of the duty of good faith and fair dealing, various business torts, including unfair competition and declaratory relief. Adler distributes and supplies anti-counterfeit document products and Mr. McTaggart is a principal of Adler. Adler had entered into several purported agreements with Thomas M. Wicker Enterprises and Document Security Consultants, both of which the Company acquired in 2002. These alleged agreements, generally, would have authorized Adler to manufacture in Canada the Company's "Checkmate®" patented system for verifying the authenticity of currency and documents. Other purported agreements were signed between these parties and Thomas Wicker regarding other technology claimed to have been owned by Wicker and assigned to the Company. Among other things, the Company contends that certain of the purported agreements are not binding and/or enforceable. To the extent any of them are binding and enforceable, the Company claims that Adler has breached these purported agreements, failed to make an appropriate accounting and payments under them, and may have exceeded the scope of its license. Adler has denied the material allegations of the complaint and has counterclaimed against the Company, claiming Adler owns or co-owns or has a license to use certain of the Company's technologies. In May 2005, the Company filed a first amended and supplemental complaint adding Blanks/USA and Raymond Maxon as additional defendants. In February 2007, the Company filed a second amended and supplemental complaint adding Judith Wu (McTaggart's wife) and Arcis Digital Security, Inc. (a company in which Ms. Wu is involved) as additional defendants. Maxon has asserted a counterclaim against the Company contending that the Company's purported acquisition of a certain patent from Thomas Wicker in 2002 gave rise to an alleged right on the part of Maxon to receive a portion of Thomas Wicker's proceeds from such acquisition. The Company has denied the material allegations of all of the counterclaims. If Adler or Maxon is successful, or if a settlement is made, it may materially affect the Company, the Company's financial condition, and the Company's ability to market and sell certain of the Company technology and related products. This case is in discovery phase, and it is too soon to determine how the various issues raised by the lawsuit will be determined.

In addition to the foregoing, we are subject to other legal proceedings that have arisen in the ordinary course of business and have not been finally adjudicated. Although there can be no assurance in this regard, in the opinion of management, none of these legal proceedings to which we are a party will have a material adverse effect on our results of operations, cash flows or our financial condition.

ITEM 1A – RISK FACTORS

We face many significant risks in our business, some of which are unknown to us and not presently foreseen. These risks could have a material adverse impact on our business, financial condition and results of operations in the future. We have disclosed a number of material risks under Item 1A of our annual report on Form 10-K for the year ended December 31, 2008, which we filed with the Securities and Exchange Commission on March 31, 2009. The following discussion is of material changes to risk factors disclosed in that report.

We have two secured credit facilities that have large principal payments due in January 2010 and a \$900,000 secured loan due in December 2009, and if we are unable to repay them with cash we may be forced to repay, in whole or in part, with each credit facility's applicable collateral, which would have a material adverse effect on our financial position.

On January 4, 2008, we entered into two credit facilities with an aggregate borrowing capacity of \$3.6 million that is repayable in full on January 4, 2010. One of these credit facilities has a borrowing limit of \$3.0 million and is secured by our stock in our Plastic Printing Professionals, Inc. subsidiary, and the other credit facility has a borrowing limit of \$600,000 and is secured by our accounts receivable, excluding the accounts receivable of our subsidiary Plastic Printing Professionals, Inc. As of September 30, 2009, we have borrowed \$3,033,000 under these credit facilities and are in default of both agreements due to a failure to pay interest when due. Both Fagenson & Co., Inc. and Patrick White have waived the defaults through January 1, 2010. In the event that the Company cannot pay these credit facilities, including the unpaid interest, when due, the Company believes that it will be able to extend the terms of these notes, or negotiate with the lenders other means of satisfying these credit facilities, including the payment of amounts due in the form of the Company's equity. There can be no assurance that such additional financing, will be available on terms acceptable to the Company or at all. Failure to raise the funds necessary to finance future cash requirements would adversely affect the Company's ability to pursue its strategy and could negatively affect operations in future periods. The accompanying financial statements do not reflect any adjustments that may be necessary in the event the Company is unsuccessful in its fundraising efforts.

On December 18, 2008, our wholly owned subsidiary, Secuprint, Inc. (dba DPI Secuprint, Inc.), entered into a secured loan of \$900,000 to pay for most of the cash portion of the purchase price of our acquisition of the assets of DPI of Rochester, LLC. The loan is due in December 2009 and is secured by all of the assets of DPI Secuprint. The Company expects to be able to refinance this obligation prior to its maturity date, however, there is no guarantee that the Company will be able to do so.

If we cannot generate sufficient cash from operations or raise cash from other sources including without limitation, fund-raising through additional sales of equity, and if we cannot refinance the credit facilities or our secured loan, we may have to repay, in whole or in part, one or all of the credit facilities or secured loan with each credit facility's or note's applicable collateral, which would have a material adverse effect on our financial position.

Due to our low cash balance and limited financing currently available to us, we may in the near future have a number of obligations that we will be unable to meet without generating additional income or raising additional capital. If we cannot generate additional income or raise additional capital in the near future, we may become insolvent, fail to obtain appropriate relief from bankruptcy, be made bankrupt and/or our stock may become illiquid or worthless.

As of September 30, 2009, our cash balance was approximately \$423,000, and our current liabilities totaled approximately \$6,688,000, which includes \$3,033,000 of short term debt under two credit facilities that are due on January 2, 2010, and a \$900,000 Secured Promissory Note due on December 19, 2009. In order to meet our operating needs and these current obligations, we will need to generate additional income from operations or obtain additional financing, including without limitation, fund-raising through additional sales of equity. We may also need to negotiate with our lenders to extend or refinance our existing credit facilities. Additionally, our ability to utilize cash generated by our DPI Secuprint subsidiary for corporate obligations is restricted by the terms of certain of its third party equipment operating leases, which could negatively affect our ability to raise cash from other sources, or to satisfy our obligations.

If we do not receive sufficient financing or sufficient funds from our operations we may (i) liquidate assets, (ii) seek or be forced into bankruptcy and/or obtain appropriate relief from bankruptcy and/or, (iii) continue operations, but incur material harm to our business, operations or financial condition. These measures could have a material adverse effect on our ability to continue as a going concern. Additionally, because of our financial condition, our Board of Directors has a duty to our creditors that may conflict with the interests of our stockholders. Our Board of Directors may be required to make decisions that favor the interests of creditors at the expense of our stockholders to fulfill its fiduciary duty. For instance, we may be required to preserve our assets to maximize the repayment of debts versus employing the assets to further grow our business and increase shareholder value. If we cannot generate enough income from our operations or are unable to locate additional funds through financing, we may not have sufficient resources to continue operations.

Due to our low cash balance and negative cash flow, we may have to further reduce our costs by curtailing future operations to continue as a business.

We have incurred significant net losses in previous years. Our ability to fund our capital requirements out of our available cash and cash generated from our operations depends on a number of factors. Some of these factors include our ability to (i) increase security and commercial printing and plastic card sales and (ii) increase sales of our digital products. While we have approximately \$567,000 of funds available to us under our various credit facilities as of September 30, 2009, that expire in January of 2010, we will need additional funds in the future in order to fund our working capital needs including equity capital. If we are not successful in generating needed funds from operations or in capital raising transactions, we may need to reduce our costs which measures could include selling or consolidating certain operations or assets, and delaying, canceling or scaling back product development and marketing programs. These measures could materially and adversely affect our ability to operate profitably.

We cannot predict our future capital needs and we may not be able to secure additional financing.

We may need to raise additional funds in the future to fund our working capital needs, to fund more aggressive expansion of our business, to complete development, testing and marketing of our products, or to make strategic acquisitions or investments. We may require additional equity or debt financings, collaborative arrangements with corporate partners or funds from other sources for these purposes. No assurance can be given that necessary funds will be available for us to finance our development on acceptable terms, if at all. Furthermore, such additional financings may involve substantial dilution of our stockholders or may require that we relinquish rights to certain of our technologies or products. In addition, we may experience operational difficulties and delays due to working capital restrictions. If adequate funds are not available from operations or additional sources of financing, we may have to delay or scale back our growth plans.

We have a large number of authorized but unissued shares of common stock, which our management may issue without further stockholder approval, thereby causing dilution of your holdings of our common stock.

As of September 30, 2009, there were approximately 185 million authorized but unissued shares of our common stock. Our management continues to have broad discretion to issue shares of our common stock in a range of transactions, including capital-raising transactions, mergers, acquisitions, for anti-takeover purposes, and in other transactions, without obtaining stockholder approval, unless stockholder approval is required for a particular transaction under the rules of the NYSE Amex, New York law, or other applicable laws. For instance, during 2009 through November 13, 2009, we have issued 1,010,000 shares of common stock and warrants to purchase an additional 202,000 shares of common stock. If our management determines to issue additional shares of our common stock from the large pool of authorized but unissued shares for any purpose in the future without obtaining stockholder approval, your ownership position would be diluted without your further ability to vote on such transaction.

We may not meet the continued listing standards of the NYSE AMEX

The Company received notice from the NYSE Amex (formerly NYSE Alternext US) on December 2, 2008 that based on a review of our Form 10-Q for the period ended September 30, 2008, the Company did not meet certain of the Exchange's continued listing standards related to stockholders' equity as set forth in Part 10 of the NYSE Amex Company Guide. The Company was afforded the opportunity to submit a plan of compliance to the Exchange and on January 9, 2009 presented its plan to the Exchange. On January 29, 2009, the Exchange notified the Company that it accepted the Company's plan of compliance and granted the Company an extension until June 2, 2010 to regain compliance with the continued listing standards and that its listing is being continued pursuant to this extension. The Company will be subject to periodic review by Exchange Staff during the extension period. Failure to make progress consistent with the plan or to regain compliance with the continued listing standards by the end of the extension period could result in the Company being delisted from the Exchange. There is no guarantee that the Company will be able to regain compliance to the listing standards and therefore, the Company's common shares may no longer be able to be traded, which could cause the market price of our common stock to decline and could impair our ability to raise capital through an offering of additional equity securities.

ITEM 2 - UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Reference is made to Item 1.01. "Entry into a Material Definitive Agreement" and Item 3.02. "Unregistered Sales of Equity Securities" of our Current Report on Form 8-K filed with the Securities and Exchange Commission on October 27, 2009 for a description of our previously reported sales of unregistered securities on October 21, 2009.

On July 15, 2009, the Company sold 24.5 investment units for \$10,000 per unit for gross cash proceeds of \$245,000, consisting of 175,000 shares of Common Stock and Warrants to purchase an aggregate of 35,000 shares of Common Stock. Each investment unit is comprised of 7,142 shares of the Company's Common Stock and five year Warrants to purchase 1,427 shares of Common Stock at an exercise price of \$2.00 per share.

On August 24, 2009, the Company completed the sale of 7 investment units in a private placement pursuant to subscription agreements with three accredited investors dated the same date. Each investment unit is comprised of 7,142 shares of the Company's common stock and five year warrants to purchase 1,427 shares of common stock at an exercise price of \$2.00 per share. In the transaction, the Company sold 7 investment units for \$10,000 per unit for gross cash proceeds of \$70,000, consisting of 50,000 shares of common stock and warrants to purchase an aggregate of 10,000 shares of common stock.

On September 4, 2009, the Company completed the sale of 44 investment units in a private placement pursuant to subscription agreements with three accredited investors dated the same date. Each investment unit is comprised of 6,250 shares of the Company's common stock and five year warrants to purchase 1,250 shares of common stock at an exercise price of \$2.00 per share. In the transaction, the Company sold 44 investment units for \$10,000 per unit for gross cash proceeds of \$440,000, less expenses of \$52,000, consisting of 275,000 shares of common stock and warrants to purchase an aggregate of 55,000 shares of common stock.

On October 19, 2009, the Company completed the sale of 17.6 investment units in a private placement pursuant to subscription agreements with three accredited investors dated the same date. Each investment unit is comprised of 6,250 shares of the Company's common stock and five year warrants to purchase 1,250 shares of common stock at an exercise price of \$2.00 per share. In the transaction, the Company sold 17.6 investment units for \$10,000 per unit for gross cash proceeds of \$176,000, consisting of 110,000 shares of common stock and warrants to purchase an aggregate of 22,000 shares of common stock.

In connection with the Transactions, the Company has entered into a Registration Rights Agreement, with each purchaser (the "Registration Rights Agreement"). Pursuant to the Registration Rights Agreement, the Company granted certain registration rights to the purchasers, including using its best efforts to file a registration statement with the Securities and Exchange Commission covering the resale of the shares of Common Stock sold in the Transaction and shares underlying the Warrants, within 90 business days after the final closing of the Transaction. The Company must use its best efforts to maintain the effectiveness of the registration statement until the earlier of (i) one year from the final closing date of the Transaction, or (ii) the date that the holders of the shares receive an opinion of counsel to the Company that all such shares may be freely traded (without limitation or restriction as to quantity or timing and without registration) pursuant to Rule 144 or otherwise. The Registration Rights Agreement, form of Subscription Agreement and Warrants are collectively referred to herein as, the "Definitive Agreements."

Copies of the Definitive Agreements relating to the Transaction are filed herewith as Exhibits 4.1, 10.1 and 10.2, and are incorporated herein by reference. The foregoing summary descriptions of the Definitive Agreements are qualified in their entirety by reference to the full texts of each of such exhibits.

The investment units, Common Stock, Warrants and Common Stock issuable upon exercise of the Warrants (the "Securities") have not been registered under the Securities Act of 1933, as amended (the "Securities Act"), and were issued and sold in reliance upon the exemption from registration contained in Section 4(2) of the Securities Act and Rule 506 of Regulation D promulgated thereunder. These securities may not be offered or sold in the United States in the absence of an effective registration statement or an applicable exemption from registration requirements.

ITEM 3 - DEFAULTS UPON SENIOR SECURITIES

On January 4, 2008, the Company entered into a Credit Facility Agreement with Fagenson and Co., Inc., as agent, a related party to Robert B. Fagenson, the Chairman of the Company's Board of Directors. Under the Fagenson Credit Agreement, the Company can borrow up to a maximum of \$3,000,000 from time to time up to and until January 4, 2010. The advances are generally limited to \$400,000 unless otherwise mutually agreed upon by both parties per fiscal quarter, with the exception of \$600,000 that can be advanced at any time for patent litigation related bills. Any amount borrowed by the Company pursuant to the Fagenson Credit Agreement will have an annual interest rate of 2% above LIBOR and will be secured by the Common Stock of Plastic Printing Professionals, Inc., ("P3") the Company's wholly owned subsidiary. Interest is payable quarterly in arrears and the principal is payable in full at the end of the term under the Fagenson Credit Agreement. In addition, on January 4, 2008, the Company also entered into a Credit Facility Agreement with Patrick White, the Company's Chief Executive Officer and a member of the Board of Directors. Under the White Credit Agreement, the Company can borrow up to \$600,000 from time to time up to and until January 4, 2010. Any amount borrowed by the Company pursuant to the White Credit Agreement will have an annual interest rate of 2% above LIBOR and will be secured by the accounts receivable of the Company, excluding the accounts receivable of P3. Interest is payable quarterly in arrears and the principal is payable in full at the end of the Term under the White Credit Agreement. Mr. White can accept common stock as repayment of the loan upon a default. Under the terms of the agreement the Company is required to comply with various covenants. As of September 30, 2009, the Company has borrowed \$3,033,000 under the Fagenson & Co., Inc. and White credit facility agreements and was in default of both agreements due to a failure to pay interest when due. Both Fagenson & Co., Inc. and Patrick White have waived the default through January 1, 2010.

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5 - OTHER INFORMATION

None

ITEM 6 - EXHIBITS

The Exhibits listed below designated by an * are incorporated by reference to the filings by Document Security Systems, Inc. under the Securities Act of 1933 or the Securities and Exchange Act of 1934, as indicated. All other exhibits are filed herewith.

(a) Exhibits

Item 3.1 Certificate of Incorporation of the Registrant, as amended (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement No. 2-98684-NY on Form S-18).

Item 3.2 By-Laws of the Registrant, as amended (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement No. 2-98684-NY on Form S-18).

Item 4.1 Form of Warrant to Purchase Common Stock of Document Security Systems, Inc. dated May 29, 2009 (incorporated by reference to Exhibit 4.1 of Form 8-K filed June 3, 2009).

Item 10.1 Form of Subscription Agreement dated as of May 29, 2009 between Document Security Systems, Inc. and the Subscribers (incorporated by reference to Exhibit 10.1 of Form 8-K filed June 3, 2009).

Item 10.2 Form of Registration Rights Agreement dated as of May 29, 2009 executed and delivered by Document Security Systems, Inc. and the holders listed therein (incorporated by reference to Exhibit 10.2 of Form 8-K filed June 3, 2009).

Item 10.3 Asset Purchase Agreement between Lester Levin Inc. and Internet Media Services, Inc. dated October 8, 2009 (Exhibits and Schedules have been omitted pursuant to Regulation S-K Item 601(b)(2), but will be provided to the SEC upon request) (incorporated by reference to Exhibit 10.2 of Form 8-K filed October 14, 2009).

Item 10.4 Registration Rights Agreement between Document Security Systems, Inc. and Internet Media Services, Inc. dated October 8, 2009 (incorporated by reference to Exhibit 10.2 of Form 8-K filed October 14, 2009).

Item 10.5 Stock Pledge and Escrow Agreement between Lester Levin Inc., Document Security Systems, Inc., Internet Media Services, Inc., Raymond Meyers and Manufacturers and Traders Trust Company dated October 8, 2009. (incorporated by reference to Exhibit 10.2 of Form 8-K filed October 14, 2009).

Item 10.6 Stock Pledge and Escrow Agreement between Lester Levin Inc., Document Security Systems, Inc., Internet Media Services, Inc., Michael Buechler and Manufacturers and Traders Trust Company dated October 8, 2009. (incorporated by reference to Exhibit 10.2 of Form 8-K filed October 14, 2009).

Item 10.7 Voting Agreement between Document Security Systems, Inc., Internet Media Services, Inc., Raymond Meyers and Michael Buechler dated October 8, 2009. (incorporated by reference to Exhibit 10.2 of Form 8-K filed October 14, 2009).

Item 31.1 Certification of Chief Executive Officer as required by Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes Oxley Act of 2002.

Item 31.2 Certification of Chief Financial Officer as required by Rule 13a-14 or 15d-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes Oxley Act of 2002.

Item 32.1 Certification of Chief Executive Officer as required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002.

Item 32.2 Certification of Chief Financial Officer as required by 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized.

DOCUMENT SECURITY SYSTEMS, INC.

November 16, 2009

By: /s/ Patrick White

Patrick White
Chief Executive Officer

November 16, 2009

By: /s/ Philip Jones

Philip Jones
Chief Financial Officer

Exhibit Index

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CERTIFICATION

I, Patrick White, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Document Security Systems, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f), for the registrant and we have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the registrant's audit committee of the board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Date: November 16, 2009

/s/Patrick White

Patrick White

Chief Executive Officer

Exhibit 31.2
CERTIFICATION

I, Philip Jones, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Document Security Systems, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15(d)-15(f), for the registrant and we have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the registrant's audit committee of the board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting;

Date: November 16, 2009

/s/ Philip Jones

Philip Jones,
Chief Financial Officer

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO SECTION 906 OF
THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Document Security Systems, Inc. (the "*Company*") on Form 10-Q for the quarter ending September 30, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "*Report*"), I, Patrick White, Chief Executive Officer of the Company certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 16, 2009

/s/Patrick White

Patrick White

Chief Executive Officer

A signed original of this written statement required by Section 906 has been provided to Document Security Systems, Inc and will be retained by Document Security Systems, Inc and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO SECTION 906 OF
THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Document Security Systems, inc. (the "*Company*") on Form 10-Q for the quarter ending September 30, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "*Report*"), I, Philip Jones, Chief Financial Officer of the Company, respectfully certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that to the best of my knowledge:

The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 16, 2009

/s/Philip Jones

Philip Jones

Chief Financial Officer

A signed original of this written statement required by Section 906 has been provided to Document Security Systems, Inc and will be retained by Document Security Systems, Inc and furnished to the Securities and Exchange Commission or its staff upon request.