

## Electronic Proof

\*\*\*\*\* **ATTENTION** \*\*\*\*\*

The format and/or verbiage of the SEC cover may have been modified to conform to SEC supplied templates and/or SEC rules and regulations.

\*\*\*\*\*

**\*\*\* CLIENT QUERY \*\*\***

**PLEASE ADVISE**

---

This proof has been created at legal-size (8.5 x 14 inch) and may not fit on letter-sized (8.5 x 11 inch) paper. If copy is cut off, please print to larger, e.g., legal-sized (8.5 x 14 inch) paper or adjust your Adobe properties to “Shrink to Printable Area”. Be advised, proofs printed to 8.5 x 11 will be reduced and the type will appear much smaller on the printed page. An 8.5 x 11 proof with abbreviated banner lines can be provided upon request.

---

Accuracy of proof is guaranteed ONLY if printed to a PostScript printer using the correct PostScript driver for that printer make and model.

---

C17782.SUB

**BPC \***

**SUBHDR**



<SUBMISSION>  
<TYPE> 10-Q  
<DOCUMENT-COUNT> 9  
<LIVE>  
<FILER-CIK> 0001411658  
<FILER-CCC> sy7w#zey  
<CONTACT-NAME> PURE COMPLIANCE  
<CONTACT-PHONE-NUMBER> 866-444-6820  
<SROS> NONE  
<SMALLER-REPORTING-COMPANY>  
<PERIOD> 03-31-2011  
<NOTIFY-INTERNET> pure.compliance@bowne.com  
<NOTIFY-INTERNET> Scott.Taylor@Bowne.com  
<NOTIFY-INTERNET> bmcdonald@digitiliti.com



<DOCUMENT>  
<TYPE> 10-Q  
<FILENAME> c17782e10vq.htm  
<DESCRIPTION> FORM 10-Q  
<TEXT>

[Table of Contents](#)

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

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended March 31, 2011

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 000-53235

**DIGITILITI, INC.**

(Exact name of Registrant as specified in its charter)

Delaware

(State or Other Jurisdiction of incorporation or organization)

26-1408538

(I.R.S. Employer Identification No.)

266 East 7<sup>th</sup> Street, 4<sup>th</sup> Floor  
St. Paul, Minnesota 55101

(Address of Principal Executive Offices)

(651) 925-3200

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

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 definitions 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   
(Do not check if 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

As of May 23, 2010, the Registrant had shares of common stock issued and outstanding.

Class

Common Stock, \$.001 par value per share

Outstanding at May 23, 2010

66,714,481 shares

DIGITILITI, INC.  
Table of Contents

Page

**PART I — Financial Information**

**Item 1. Financial Statements (unaudited):**

<u>Consolidated Balance Sheets — As of March 31, 2011 and December 31, 2010</u>	3
<u>Consolidated Statements of Operations — Three months ended March 31, 2011 and 2010</u>	4
<u>Consolidated Statements of Cash Flows — Three months ended March 31, 2011 and 2010</u>	5
<u>Notes to Consolidated Financial Statements</u>	6

<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	12
--	----

<u>Item 4. Controls and Procedures</u>	17
--	----

**PART II — Other Information**

<u>Item 1. Legal Proceedings</u>	18
----------------------------------	----

<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	18
--	----

<u>Item 3. Defaults Upon Senior Securities</u>	18
--	----

<u>Item 6. Exhibits</u>	18
-------------------------	----

<u>Signatures</u>	19
-------------------	----

- EX-10.1
- EX-10.2
- EX-10.3
- EX-10.4
- EX-10.5
- EX-31.1
- EX-31.2
- EX-32.1

**Table of Contents**

PART I — FINANCIAL INFORMATION

**Item 1. Financial Statements**

**DIGITILITI, INC.  
 CONSOLIDATED BALANCE SHEETS  
 (UNAUDITED)**

	March 31, 2011	December 31, 2010
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash	\$ 1,654	\$ 27,557
Accounts receivable	284,360	333,687
Prepaid and other current assets	340,371	247,970
Total current assets	626,385	609,214
Property and equipment, net	127,649	158,105
Software license, net	365,557	436,608
Deferred financing costs	139,340	4,466
Other assets	6,322	6,322
Total assets	<u>\$ 1,265,253</u>	<u>\$ 1,214,715</u>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 735,532	\$ 692,923
Accrued expenses	564,325	554,978
Bank overdraft	5,472	—
Deferred income	9,989	9,989
Notes payable	—	231,540
Note payable — related party	16,000	—
Current maturities of convertible debt, net of unamortized discounts of \$3,333 and \$0	539,038	782,941
Current maturities of capital lease obligations	13,531	23,308
Total current liabilities	1,883,887	2,295,679
Convertible debt, non-current, net of unamortized discounts of \$540,179 and \$0	760,949	250,000
Other liabilities	3,607	3,607
Total liabilities	<u>2,648,443</u>	<u>2,549,286</u>
<b>STOCKHOLDERS' DEFICIT</b>		
Series A Convertible Preferred Stock, \$0.001 par value; 1,200,000 shares authorized for Series A, 668,720 and 724,187 shares issued and outstanding	669	724
Series B Convertible Preferred Stock, \$1.00 par value; 2,000,000 shares authorized for Series B, 420,000 shares issued and outstanding	420,000	420,000
Common stock, \$.001 par value; 125,000,000 shares authorized, 66,714,481 and 65,699,753 shares issued and outstanding	66,714	65,700
Additional paid-in capital	25,269,583	24,409,477
Accumulated deficit	(27,140,156)	(26,230,472)
Total stockholder's deficit	(1,383,190)	(1,334,571)
Total liabilities and stockholder's deficit	<u>\$ 1,265,253</u>	<u>\$ 1,214,715</u>

*See accompanying notes to unaudited consolidated financial statements.*

[Table of Contents](#)

**DIGITILITI, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2011</b>	<b>2010</b>
REVENUES	\$ 411,029	\$ 625,127
COST OF REVENUES	(519,059)	(301,971)
GROSS PROFIT (LOSS)	(108,030)	323,156
OPERATING EXPENSES		
Selling and marketing	143,065	214,664
General and administrative	363,575	458,631
Research and development	147,853	269,742
Total Operating Expenses	654,493	943,037
LOSS FROM OPERATIONS	(762,523)	(619,881)
OTHER EXPENSES		
Loss on extinguishment of debt	71,634	—
Interest expense	75,527	228,130
Total other expenses	147,161	228,130
NET LOSS	\$ (909,684)	\$ (848,011)
NET LOSS PER SHARE — BASIC AND DILUTED	\$ (0.01)	\$ (0.02)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING — BASIC AND DILUTED	66,011,034	41,318,675

*See accompanying notes to unaudited consolidated financial statements.*

[Table of Contents](#)

**DIGITILITI, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>OPERATING ACTIVITIES</b>		
Net loss	\$ (909,684)	\$ (848,011)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation expense	31,391	84,258
Amortization of software license	71,051	75,195
Amortization of deferred financing costs	8,861	19,722
Amortization of debt discounts	24,787	64,617
Loss on extinguishment of debt	71,634	—
Warrant expense	18,039	—
Common shares issued for services	10,000	40,995
Employee stock option expense	135,593	59,086
Changes in operating assets and liabilities:		
Accounts receivable	49,327	61,412
Prepaid and other current assets	(92,401)	(21,742)
Accounts payable	75,085	(7,148)
Accounts payable — related parties	—	(7,861)
Accrued expenses	89,588	170,044
Deferred rent	(764)	(2,396)
Net cash used in operating activities	<u>(417,493)</u>	<u>(311,829)</u>
<b>INVESTING ACTIVITIES</b>		
Purchase of property and equipment	(935)	(41,317)
Purchase of software license	—	(3,782)
Net cash used in investing activities	<u>(935)</u>	<u>(45,099)</u>
<b>FINANCING ACTIVITIES</b>		
Bank overdraft	5,472	—
Proceeds from sale of common stock, net of issuance costs	—	765,300
Payments on capital lease obligations	(9,777)	(10,829)
Proceeds from notes payable — related parties	16,000	—
Proceeds from convertible debt	760,000	—
Payments on notes payable	(231,540)	(364,572)
Payments on convertible debt	(147,630)	(70,000)
Net cash provided by financing activities	<u>392,525</u>	<u>319,899</u>
<b>NET DECREASE IN CASH</b>	<b>(25,903)</b>	<b>(37,029)</b>
Cash at beginning of year	27,557	141,086
Cash at end of year	<u>\$ 1,654</u>	<u>\$ 104,057</u>
<b>SUPPLEMENTAL CASH FLOWS INFORMATION</b>		
Cash paid for interest	\$ 9,746	\$ 12,842
Cash paid for income taxes	—	—
<b>NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>		
Convertible debt issued for debt issuance costs	64,000	—
Warrants issued for debt issuance costs	79,735	—
Accrued interest converted to convertible debt	8,844	—
Debt discount due to warrants issued with debt	316,226	—
Debt discount due to beneficial conversion feature	126,729	—
Debt discount	118,284	—
Common stock issued for the conversion of Series A preferred stock	277	—
Common stock issued for accrued interest	103,109	—
Notes payable issued for maintenance fees	—	56,634
Accrued interest converted to debt principal	—	24,646

[Table of Contents](#)

**DIGITILITI, INC.  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

**1. Basis of Presentation**

The accompanying unaudited interim consolidated financial statements of Digitiliti, Inc. (the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and with the instructions to Form 10-Q and Article 8 of Regulation S-X under the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. These consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes included in the Company’s Form 10-K for the year ended December 31, 2010, filed with the Securities and Exchange Commission (“SEC”) on April 14, 2011. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been reflected herein. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year.

*Software Revenue Recognition*

The Company derives its revenue from sales of its products and services. Product revenue is derived from sales of the Company’s DigiBak and DigiLibe service.

The DigiBak service provides an offsite storage solution through a “utility based computing philosophy” where customers pay for the gigabytes of data they store in the DigiBak vault.

The DigiLibe service is a multiple element software sales arrangement that is comprised of three key components that act as one: Client Agent, Information Director, and Archive Information Store.

For multiple element software license sales arrangements that do not require significant modification or customization of the underlying software, we recognize revenue when: (1) we enter into a legally binding software arrangement with a customer for the license of software, (2) we deliver the software, (3) price is deemed fixed or determinable and free of contingencies of significant uncertainties and (4) collection is probable.

For sales arrangements with multiple elements, we defer revenue for any undelivered elements, and recognize revenue when the product is delivered or over the periods in which the service is performed. If we cannot objectively determine the fair value of any undelivered element included in bundled arrangements, we defer revenue until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements.

*Correction of a Prior Period*

During the year ended December 31, 2010, the Company discovered and corrected an error related to options granted to an employee that were inadvertently omitted from the Company’s employee stock option expense from April 2008 through September 30, 2010. The error resulted to an understatement in stock compensation expense and additional paid in capital. In accordance with the SEC’s Staff Accounting Bulletin Nos. 99 and 108 (SAB 99 and SAB 108), the Company evaluated this error and, based on an analysis of quantitative and qualitative factors, determined that the error was immaterial to each of the prior reporting periods affected. However, if the adjustments to correct the cumulative effect of the above error had been recorded in the year ended December 31, 2010, the Company believes the impact would have been significant and would impact comparisons to prior periods. Therefore, as permitted by SAB 108, the Company corrected, in the current filing, previously reported results for the three months ended March 31, 2010.

**Table of Contents**

The following table shows the impact of the error to the unaudited Consolidated Statements of Operations for the three months ended March 31, 2010:

	<b>Three Months Ended March 31, 2010</b>		
	<b>As Previously Reported</b>	<b>Adjustments</b>	<b>As Revised</b>
General and administrative	\$ 175,293	\$ 39,371	\$ 214,664
Total operating expenses	903,666	39,371	943,037
Net loss from operations	(580,510)	(39,371)	(619,881)
Net loss	<u>\$ (808,640)</u>	<u>\$ (39,371)</u>	<u>\$ (848,011)</u>
Net loss per share — Basic and Diluted	\$ (0.02)	\$ —	\$ (0.02)
Weighted average shares outstanding — Basic and Diluted	41,318,675	—	41,318,675

The adjustment to the unaudited Consolidated Statement of Cash Flows for three months ended March 31, 2010 did not result in any changes to the amounts previously reported for net cash from operating activities, investing activities or financing activities.

*New Accounting Pronouncements*

In October 2009, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2009-13, “Multiple-Deliverable Revenue Arrangements” (“ASU 2009-13”) which:

- (i) provides updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated;
- (ii) requires an entity to allocate revenue in an arrangement using estimated selling prices (ESP) of deliverables if a vendor does not have vendor-specific objective evidence of selling price (VSOE) or third-party evidence of selling price (TPE);
- (iii) eliminates the use of the residual method and requires an entity to allocate revenue using the relative selling price method; and
- (iv) expands the disclosure requirements to require an entity to provide both qualitative and quantitative information about the significant judgments made in applying the revised guidance and subsequent changes in those judgments that may significantly affect the timing or amount of revenue recognition.

In addition, in October 2009, the FASB also issued ASU No. 2009-14, “Certain Revenue Arrangements That Include Software Elements” (“ASU 2009-14”) to amend the accounting standards for revenue recognition to exclude tangible products containing software components and non-software components that function together to deliver the tangible product’s essential functionality from the scope of the software revenue recognition guidance. The revised revenue recognition accounting standards are effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 and shall be applied on a prospective basis. The above pronouncements were effective for the Company beginning the first quarter of 2011. The adoption of the above guidance did not impact the Company’s consolidated financial statements.

No other new accounting pronouncement issued or effective has had, or is expected to have, a material impact on the Company’s consolidated financial statements

**2. Going Concern**

As shown in the accompanying financial statements, the Company incurred net loss of \$909,684 for the three months ended March 31, 2011 and had a working capital deficit of \$1,257,502 as of March 31, 2011. These conditions raise substantial doubt as to the Company’s ability to continue as a going concern.

The Company continues to be dependent on its ability to generate future revenues, positive cash flows and additional financing. There can be no guarantee that the Company will be successful in generating future revenues, in obtaining additional debt or equity financing or that such additional debt or equity financing will be available on terms acceptable to the Company. The financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

---

## [Table of Contents](#)

### **3. Notes Payable**

During the three months ended March 31, 2011, the Company repaid a previously issued note payable of \$231,540.

During the three months ended March 31, 2011, the Company borrowed \$16,000 from a member of the Company's Board of Directors. The note is unsecured, bears interest at 12% per annum and matures on June 25, 2011.

### **4. Convertible Debt**

On February 28, 2011, the Company completed the placement of \$1,182,844 Secured Convertible Promissory Note (the "Notes") and Warrants (collectively, the "Secured Convertible Debt Offering"). The Lenders in the Secured Convertible Debt Offering paid a 10% discount for their investment, resulting in a "stepped-up" basis in their individual Notes for a total principal amount of \$1,301,128. The Notes bear interest at the rate of 12% per annum, have an 18-month maturity date and are convertible to common shares at \$0.20 per share. The Notes are secured by a first lien on all assets of the Company; but are subordinate to the lien with respect to up to \$100,000 of original principal amount of other notes against the Company's vault.

In conjunction with the Secured Convertible Debt Offering, the Lenders received warrants to purchase an aggregate of 3,252,821 common shares. The warrants vested immediately, have a five year term, a \$0.30 exercise price and are redeemable by the Company in the event of an acquisition. The Company valued the warrants using the Black-Scholes option pricing model. The warrants include antidilution provisions for stock splits, stock dividends and recapitalization.

\$250,000 of the cash proceeds under the Secured Convertible Debt Offering were received by the Company during November and December of 2010 in the form of advanced convertible notes. The notes originally matured at the earlier of the closing of the Secured Convertible Debt Offering or May and June of 2012, had an interest rate of 12% per annum and were convertible into common shares at \$0.20 per share. The principal and accrued interest amounting to \$250,000 and \$8,844, respectively, were converted into Notes under the Secured Convertible Debt Offering upon closing.

In conjunction with the sale of the 12% Secured Convertible Debt Offering, the Company paid consultants fees totaling \$64,000 and issued 170,000 5-year warrants with an exercise price of \$0.20 per share and 363,000 5-year warrants with an exercise price of \$0.30 per share. The fees were paid through the issuance of Notes in the 12% Secured Convertible Debt Offering. The fees and the fair value of the warrants totaling \$143,735 were recorded as deferred financing costs and amortized using the effective interest method over the term of the Notes.

Amortization expense on deferred financing costs for the three months ended March 31, 2011 and 2010 amounted to \$8,861 and \$19,722, respectively. Unamortized deferred financing costs amounted to \$139,340 as of March 31, 2011.

The Company analyzed the Secured Convertible Debt Offering for derivative accounting under FASB ASC 815-15 and determined that derivative accounting does not apply to these instruments.

The Secured Convertible Debt Offering was then evaluated for a beneficial conversion feature and it was determined that a beneficial conversion feature existed. The intrinsic value of the beneficial conversion feature was determined to be \$126,729. In addition, the relative fair value of the warrants was measured using the Black-Scholes option pricing model and determined to be \$316,226 and recorded as a debt discount. The 10% face discount on the Notes was determined to be \$118,284 resulting in an aggregate discount of \$561,239 being recorded on the Notes. The aggregate discount is being amortized over the life of the Notes using the effective interest method. The amortization expense recorded on these discounts for the three months ended March 31, 2011 totaled \$21,061 resulting in a total unamortized discount of \$540,179 as of March 31, 2011.

**Table of Contents**

On February 28, 2011, the Company entered into an agreement to repay and modify three debt obligations owed to two stockholders. The debt obligations owed to these two stockholders were secured by a first lien on the Company’s assets and consisted of the following: a \$250,000 12% secured convertible note issued in November 2008 with a \$0.35 per share conversion rate; a \$50,000 payable that was due on demand and bore interest at 10% per annum; and a \$231,540 6% promissory note that was due on demand. The terms of the agreement provided for the repayment of \$431,540 of principal on the combined debt and payable with the remaining principal balance owed of \$100,000 being converted into a Note under the Secured Convertible Debt Offering. In addition, the outstanding accrued interest owed to these two stockholders of \$103,109 was paid through the issuance 687,393 common shares. Under the agreement, the terms of 350,000 warrants previously granted to these stockholders were modified whereby the exercise price was reduced to \$0.15 and the term changed to 5 years. An additional 200,000 warrants with a 5-year term and a \$0.30 per share exercise price were also granted to these stockholders. As of March 31, 2011, there remained an outstanding a balance of \$2,371 on the \$250,000 12% secured convertible note, which was fully paid on April 21, 2011. After this final payment, the stockholders released their first lien in the Company’s assets in preference to those Lenders associated with the Secured Convertible Debt Offering.

The Company evaluated the modification of the \$100,000 owed to these two stockholders into the 12% Secured Convertible Debt Offering under FASB ASC 470-50 and determined that the modification was substantial and qualified as a debt extinguishment. The incremental increase in the fair value of the 350,000 modified warrants of \$384, the fair value of the additional 200,000 warrants issued of \$30,000 and the fair value of the 275,000 warrants issued under the terms of the Secured Debt Offering of \$41,250 were recorded as a loss on the extinguishment of debt for the three months ended March 31, 2011.

A summary of the changes in convertible debt for the three months ended March 31, 2011, is as follows:

Convertible debt, net at December 31, 2010	\$ 1,032,941
Add: Notes issued	951,128
Less: 10% discount on the Notes	(118,284)
Less: discount due to relative fair value of warrants	(316,226)
Less: discount due to beneficial conversion feature	(126,729)
Less: principal payments	(147,630)
Add: amortization of debt discounts	24,787
Convertible debt, net at March 31, 2011	<u>\$ 1,299,987</u>
Less: current maturities, net	<u>(539,038)</u>
Long-term portion of convertible debt, net	<u>\$ 760,949</u>

**5. Common Stock**

During the three months ended March 31, 2011, the Company:

- a) issued 50,000 common shares for services valued at \$10,000,
- b) issued 687,393 common shares to repay accrued interest of \$103,109 (see also Note 4) and
- c) issued 277,335 common shares for the conversion of 55,467 Series A preferred shares.

**6. Stock Options**

During the the three months ended March 31, 2011, options to purchase 1,200,000 common shares were granted by the Company to certain employees at an exercise price of \$0.19 per share. These options have a contractual term of 5 years, and a vesting term of 3 years with 154,566 of the options fully vested at grant date. The options have a fair value of \$227,872 which was calculated using the Black-Scholes option-pricing model. Variables used in the valuation include (1) discount rate of 1.44%, (2) expected life of 4.0 years (3) expected volatility of 344.12% and (4) zero expected dividends.

During the three months ended March 31, 2011, options to purchase 200,707 common shares were granted by the Company to certain officers, as payment of a portion of their salaries, at an exercise price of \$0.19 per share. These options have a contractual term of 5 years, and vest monthly through June 30, 2011. The options have a fair value of \$38,014 which was calculated using the Black-Scholes option-pricing model. Variables used in the valuation include (1) discount rate of 1.05%, (2) expected life ranging from 2.51 to 2.72 years (3) expected volatility of 366.57% and (4) zero expected dividends.

**Table of Contents**

During the three months ended March 31, 2011, options to purchase 250,000 common shares were granted by the Company to three employees at an exercise price of \$0.19 per share. These options have a contractual term of 5 years, and a vesting term of 3 years. The options have a fair value of \$47,473 which was calculated using the Black-Scholes option-pricing model. Variables used in the valuation include (1) discount rate of 1.44%, (2) expected life of 4.0 years (3) expected volatility of 344.12% and (4) zero expected dividends.

A summary of option activities for the three months ended March 31, 2011 is reflected below:

	<u>Options</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted Average Remaining Life (yrs)</u>
Outstanding at December 31, 2010	2,990,000	\$ 0.34	
Granted	1,650,707	0.19	
Canceled	—	—	
Forfeited	—	—	
Outstanding at March 31, 2011	<u>4,640,707</u>	\$ 0.28	3.6
Exercisable at March 31, 2011	<u>2,431,917</u>	\$ 0.33	3.0

The weighted average grant date fair value of options granted in 2011 was \$0.19. The outstanding options at March 31, 2011 have an intrinsic value of zero.

Stock option expense for the three months ended March 31, 2011 and 2010 amounted to \$135,593 and \$19,715, respectively. As of March 31, 2011, there was approximately \$243,720 of unrecognized cost which is expected to be recognized through January 2014.

**7. Stock Warrants**

In conjunction with the Company's Secured Convertible Debt Offering (see Note 4), the Company issued an aggregate of 3,252,821 warrants with an exercise price of \$0.30 per share. These warrants have a term of 5 years, vested immediately and have a fair value of \$487,918, as calculated using the Black-Scholes option pricing model. Variables used in the valuation include: (1) discount rate of 2.13%, (2) warrant life of five years, (3) expected volatility of 400.26% and (4) zero expected dividends. The relative fair value of the 2,977,821 warrants of \$316,226 was recorded as a debt discount and the fair value of the 275,000 warrants of \$41,250 was included in the calculation of the loss on the extinguishment of debt during the three months ended March 31, 2011.

In addition, the Company issued 200,000 warrants with an exercise price of \$0.20 per share to the two stockholders whose outstanding note of \$100,000 was converted into the Secured Convertible Debt Offering (see Note 4). These warrants have a term of 5 years, vested immediately and have a fair value of \$30,000, as calculated using the Black-Scholes option pricing model. Variables used in the valuation include: (1) discount rate of 2.13%, (2) warrant life of five years, (3) expected volatility of 335.62% and (4) zero expected dividends. The fair value of these warrants was included in the calculation of the loss on the extinguishment of debt during the three months ended March 31, 2011.

During the three months ended March 31, 2011, 170,000 warrants with an exercise price of \$0.20 per share were granted to an individual who provided services in connection with the Company's Secured Convertible Debt Offering (see Note 4). These warrants have a term of five years and vested immediately. The warrants have a fair value of \$25,500 which was calculated using the Black-Scholes option pricing model. Variables used in the valuation include (1) discount rate of 1.18%, (2) warrant life of five years, (3) expected volatility of 400.26% and (4) zero expected dividends. The fair value of these warrants was recorded as deferred financing costs during the three months ended March 31, 2011.

During the three months ended March 31, 2011, 363,000 warrants with an exercise price of \$0.30 were granted to an individual who provided services in connection with the Company's Secured Convertible Debt Offering (see Note 4). These warrants have a term of five years and vested immediately. The warrants have a fair value of \$54,235 which was calculated using the Black-Scholes option pricing model. Variables used in the valuation include (1) discount rate of 1.18%, (2) warrant life of five years, (3) expected volatility of 344.35% and (4) zero expected dividends. The fair value of these warrants was recorded as deferred financing costs during the three months ended March 31, 2011.

**Table of Contents**

During the three months ended March 31, 2011, 10,000 warrants with an exercise price of \$0.20 per share were granted to an individual who provided consulting services to the Company. These warrants have a term of five years and vested immediately. The warrants have a fair value of \$1,300 which was calculated using the Black-Scholes option-pricing model. Variables used in the valuation include (1) discount rate of 1.18%, (2) warrant life of five years, (3) expected volatility of 400.90% and (4) zero expected dividends.

During the three months ended March 31, 2011, the Company modified the terms of 350,000 previously granted warrants whereby the exercise price was reduced to \$0.15 per share and the term was changed to 5 years. The incremental increase in the fair value of the warrants was determined to be \$384 using the Black-Scholes option-pricing model. Variables used in the valuation include (1) discount rate of 1.18%, (2) expected terms ranging from 2.7 to 5.0 years, (3) expected volatility of 344.22% and (4) zero expected dividends. The incremental increase in the fair value of these warrants was included in the calculation of the loss on the extinguishment of debt during the three months ended March 31, 2011.

A summary of warrant activities for the three months ended March 31, 2011 is as follows:

	<u>Warrants</u>	<u>Weighted-Average Exercise Price</u>	<u>Weighted Average Remaining Life (yrs)</u>
Outstanding at December 31, 2010	8,683,348	\$ 0.64	
Granted	3,995,821	0.29	
Forfeited	—	—	
Outstanding at March 31, 2011	<u>12,679,169</u>	\$ 0.53	3.85
Exercisable at March 31, 2011	<u>12,679,169</u>	\$ 0.53	3.85

The weighted average grant date fair value of warrants granted during 2011 was \$0.15. The outstanding warrants at March 31, 2011 have an intrinsic value of zero.

Warrants expense for the three months ended March 31, 2011 and 2010 was \$18,039 and \$0, respectively.

**8. Commitments and Contingencies**

Some of the Company’s convertible note holders have not accepted offers to convert their notes under the terms of the Modification Proposal issued in 2009 and Incentive Offer from 2010, or otherwise. The Company is presently in arrears in principal and accrued interest payments in an aggregate total of \$278,563 as of March 31, 2011. Although the Company is continuing to discuss payment and/or conversion or extension of these notes with note holders, these outstanding obligations pose a risk to the Company’s ongoing operations.

From time to time, Digitiliti may be subject to routine litigation, claims, or disputes in the ordinary course of business. In the opinion of management; no pending or known threatened claims, actions or proceedings against Digitiliti are expected to have a material adverse effect on Digitiliti’s consolidated financial position, results of operations or cash flows. Digitiliti cannot predict with certainty, however, the outcome or effect of any of the litigation or investigatory matters specifically described above or any other pending litigation or claims. There can be no assurance as to the ultimate outcome of these lawsuits and investigations.

**9. Subsequent Events**

During April and May 2011, the Company sold an aggregate of 1,800,000 common shares for cash proceeds of \$90,000.

On April 8, 2011, the Company borrowed \$50,000 from a third party. The loan is unsecured, matures October 8, 2011 and bears interest at 12% per annum. In connection with the loan, the Company issued to the lender 25,000 warrants exercisable at \$0.20 per share. The warrants vest immediately and have a term of five years.

---

## [Table of Contents](#)

### **Item 2. Management’s Discussions and Analysis of Financial Condition and Results of Operations.**

#### **Forward-looking Statements**

This quarterly report contains “forward-looking statements ” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements concern goals, beliefs, plan objectives, intentions, expectations, financial condition, results of operations, future performance, business strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts. Such forward-looking statements are preceded by, followed by or include the words “may,” “would,” “could,” “should,” “expects,” “projects,” “anticipates,” “believes,” “estimates,” “plans,” “intends,” “targets” or similar expressions.

Forward-looking statements involve inherent risks and uncertainties, and important factors (many of which are beyond our control) that could cause actual results to differ materially from those set forth in the forward-looking statements, including the following: general economic or industry conditions, nationally and/or in the communities in which we may conduct business, changes in the interest rate environment, legislation or regulatory requirements, conditions of the securities markets, our ability to raise capital, changes in accounting principles, policies or guidelines, financial or political instability, acts of war or terrorism, other economic, competitive, governmental, regulatory and technical factors affecting our current or potential business and related matters. Accordingly, results actually achieved may differ materially from expected results in these statements.

The information in this quarterly report is as of March 31, 2011, or, where clearly indicated, as of the date of this filing. Forward-looking statements speak only as of the date they are made. We do not undertake, and specifically disclaim, any obligation to update any forward-looking statements to reflect events or circumstances occurring after the date of such statements. We also may make additional disclosures in our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K that we may file from time to time with the SEC. Please also note that we provide a cautionary discussion of risks and uncertainties under the section entitled “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2010. These are factors that could cause our actual results to differ materially from expected results. Other factors besides those listed could also adversely affect us.

Plan of Operation

#### **The Business**

Our business is developing and delivering superior information management technologies and methodologies enabling our customers to manage, control, protect and access their information and data simply and cost effectively. Our traditional business is providing a cost effective on-line data protection solution to the small to medium business (“SMB”) and small to medium enterprise (“SME”) markets through our DigiBAK service.”. This on-line cloud storage management solution helps organizations properly manage and protect their entire network from one centralized location.

Our emerging business product, released in the first quarter of 2010, is called DigiLIBE. We believe that DigiLIBE is a game-changing product that addresses the desperate need for a fiscally responsible, integrated system to manage the increasing growth, volume, and diversity of unstructured data that now represents up to 85% of enterprise information and continues to grow rapidly. Content chaos is overwhelming companies’ ability to meet compliance, utilize collaboration tools and optimize storage needs for their virtualized infrastructures.

DigiBAK and DigiLIBE are complementary products — DigiBAK providing cloud storage backup and recovery of structured data and operating system files and DigiLIBE offers information management and life-cycle control of unstructured data from end-user through archiving and back to the end user.

---

[Table of Contents](#)

**Growing both Business Segments:**

We believe the benefits of seeking to grow both the DigiBAK and DigiLIBE businesses are:

- (i) solving a major industry and customer problem of managing continually growing information volume and associated cost of storage and retrieval;
- (ii) being able to access a larger share of opportunity in the information management storage business;
- (iii) offering significant technological advantages in corporate policy level control of information and ability to leverage knowledge from the information it creates; and
- (iv) optimizing how we synergistically allocate capital and resources between both business.

**Table of Contents**

DigiLIBE has received excellent feedback on the capability, performance, and function it delivers since its initial release. Our sales and prospecting efforts have also reaffirmed the potential of selling DigiBAK services as part of a DigiLIBE sale.

To date, Digitiliti has achieved significant market recognition and brand value having successfully established its presence in several vertical markets such as Finance, Legal, Telco, Managed Service Provider, Healthcare, Information Technology Services, and Management Consulting. In June 2010, DigiLIBE won the Tech Awards Circle Gold Award in the Midrange Software category. In briefings, leading industry analysts have described DigiLIBE as a unique and potentially disruptive product integrating both the storage management and information management markets.

“The first company to demonstrate that it can genuinely bridge the gap between storage and information management will make existing products look archaic by comparison”

Joseph Martins, Managing Director, Data Mobility Group LLC

We believe DigiLIBE is a fiscally responsible solution at a price, performance, and ease of use level that disrupts the current competitors’ point solution landscape and positions while exceeding customers’ expectations and needs. We also believe this product represents a significant step toward our goal of becoming a technology leader in the information content and context management marketplace.

## Table of Contents

### **Liquidity and Capital Resources**

Our liquidity is dependent, in the short term, on proceeds from newly issued debt and the sale of our common stock for cash. In the long term, we may need to continue expanding our capacity of the Data Storage Center by investing in property and equipment and software licenses.

We have financed our operations, debt service and capital requirements through cash flows generated from operations, the issuance of secured and unsecured convertible debt financing, capital leases and issuance of equity securities. We had a working capital deficit of \$1,686,465 at December 31, 2010 and at March 31, 2011, we had a working capital deficit of \$1,257,502. We had cash of \$1,654 as of March 31, 2011, compared to cash of \$27,557 as of December 31, 2010.

On February 28, 2011, the Company completed the placement of \$1,182,844 Secured Convertible Promissory Note and Warrants (the "Secured Convertible Debt Offering"). All of the securities issued in conjunction with the Secured Convertible Debt Offering were sold to "accredited investors" as those terms are defined on Rule 501 of Regulation D of the Securities and Exchange Commission, and each such person had prior access to all material information about the Company. The offer and a sale of these securities were exempt from the registration requirements of the Securities Act of 1933, as amended (the "Securities Act"), pursuant to, among other reasons, Section 4(2) and 4(6) thereof, and Rule 506 of Regulation D of the Securities and Exchange Commission. Registration of sales to "accredited investors" are preempted from state regulation.

The Lenders in the Secured Convertible Debt Offering paid a 90% of the principal amount for their investment, resulting in a "stepped-up" basis in their individual Secured Convertible Promissory Notes. The Secured Convertible Promissory Notes bear interest at the rate of 12% per annum, have an 18-month maturity date and a \$.20 per share conversion rate in the Company's common stock. The Secured Convertible Promissory Notes are secured by a first lien on all assets of the Company; provided, however, that the Lenders agreed to subordinate to a lien with respect to up to \$100,000 of original principal amount of other notes against the Company's vault.

On February 28, 2011, the Company entered into an agreement with two stockholders to repay and modify three debt obligations owed to the two stockholders. The debt obligations owed to these two stockholders were secured by a first lien on the Company's assets and consisted of the following: a \$250,000 12% secured convertible note issued in November 2008 with a \$0.35 per share conversion rate; a \$50,000 payable that was due on demand and bore interest at 10% per annum; and a \$231,540 6% promissory note that was due on demand. The terms of the agreement provided for the repayment of \$431,540 of principal on the combined debt and payable with the remaining principal balance owed of \$100,000 being converted into a secured promissory note under the Secured Convertible Debt Offering. In addition, the outstanding accrued interest of \$103,109 owed to these two stockholders was paid through the issuance 687,393 common shares of the Company. Under the agreement, the terms of 350,000 common stock warrants previously granted to these stockholders were modified whereby their exercise price was reduced \$0.15 and their term was changed to 5 years. An additional 200,000 common stock warrants with a five year term and a \$0.30 per share exercise price were also granted to these stockholders. As of March 31, 2011, there remained an outstanding a balance of \$2,371 on the \$250,000 12% secured convertible note, which was satisfied in full on April 21, 2011. After this final payment of \$2,371 and completion of all documentation reflecting the repayment of the Miner Debt, the Miners released their first lien in the Company's assets in preference to those Lenders associated with the Secured Convertible Debt Offering.

The Company evaluated the modification of the \$100,000 owed to these two stockholders into the 12% Secured Convertible Debt Offering under FASB ASC 470-50 and determined that the modification was substantial and qualified as a debt extinguishment. The incremental increase in the fair value of the 350,000 modified warrants of \$384, the fair value of the additional 200,000 warrants issued of \$30,000 and the fair value of the 275,000 warrants issued under the terms of the Secured Debt Offering of \$41,250 were included in the calculation of the loss on extinguishment of debt resulting in a total loss on the extinguishment of debt of \$71,634 for the three months ended March 31, 2011.

We used \$417,493 of net cash in operating activities for the three months ended March 31, 2011, compared to using \$311,829 for the three months ended March 31, 2010. Cash used in operating activities during the three months ended March 31, 2011, funded a net loss of \$909,684. This net loss was offset by non-cash charges of \$102,442 for amortization and depreciation, \$135,593 associated with stock options expense, \$71,634 related to a loss on the extinguishment of debt, \$33,648 related to amortization of the discount on our convertible debt and deferred financing costs and \$28,039 related to common stock issued for services and warrants expense. In addition, the Company's operating activities generated \$49,327 from a decrease in accounts receivable that helped support a \$164,673 increase in accounts payable and accrued expenses, which served to support an increase of \$92,401 in prepaid expenses. We used \$311,829 of net cash from operating activities for the three months ended March 31, 2010. Cash used in operating activities during the three months ended March 31, 2010, funded a net loss of \$808,640. This net loss was offset by non-cash charges of \$159,453 for amortization and depreciation, \$19,715 associated with stock options expense, \$40,995 related to common stock issued for services and \$84,339 related to amortization of discounts on our convertible debt and deferred financing costs. In addition, the Company's operating activities generated \$61,412 from a decrease in accounts receivable that helped support a \$170,044 increase in accrued expenses.

Net cash flows used in investing activities was \$935 for the three months ended March 31, 2011, compared to net cash flows used in investing activities of \$45,099 for the three months ended March 31, 2010. Both comparable totals are attributed to our purchase of property and equipment and software licenses during these two periods.

Net cash flow provided by financing activities was \$392,525 for the three months ended March 31, 2011, compared to net cash provided by financing activities of \$319,899 for the three months ended March 31, 2010. During three months ended March 31, 2011, cash provided by financing activities is primarily due to proceeds of \$760,000 received from the sale of convertible notes. We used these proceeds to make \$9,777 in capital lease payments, \$231,540 in payments on notes payable and \$147,630 of payments on convertible debt. During three months ended March 31, 2010, cash provided by financing activities is primarily due to proceeds of \$765,300 received from issuance of our common stock, net of related issuance costs. We used these proceeds to make \$10,829 in capital lease payments, \$364,572 in payments on notes payable and \$70,000 of payments on convertible debt.

**[E/O]**

CRC: 16524  
**EDGAR 2**

**BPC C17782 015.00.00.00-1 0/5**



As of March 31, 2011, the Company had \$278,563 of debt and accrued interest outstanding from the \$5.5 million offering and \$121,167 of debt and accrued interest outstanding from the \$750,000 secured offering.

---

## Table of Contents

### Results of Operations

#### For the three month periods ended March 31, 2011 and 2010

Sales for the three months ended March 31, 2011 decreased 34% to \$411,029 compared to \$625,127 for the three months ended March 31, 2010 reflecting a \$214,098 decrease in revenue. This loss in revenue is a result of increasing competitive pricing pressure from an ever-expanding range of alternative archiving storage services, a weak economy, and loss of a small number of larger customers where the cost of outsourcing archiving services become prohibitive to them. In response to these challenges, we have continued to restructure our resources, strengthen our VAR and customer relationships, reposition and rebrand our offering, initiate stronger sales efforts and refine other aspects of the DigiBAK business to sustain our margins. Despite this decrease in revenue, we increased our customer count from 805 as of March 31, 2010 to 901 as of March 31, 2011 and our current customer base remains highly satisfied with our DigiBAK service offering.

Gross margin for the three months ended March 31, 2011 was a loss of \$108,030 compared to a profit of \$323,156 for the three months ended March 31, 2010. This significant decrease in margin results from a one-time charge of approximately \$277,000 the Company incurred during the three months ended March 31, 2011 that pertained to modifications and repairs made to our vault facilities that could not be capitalized and charged over future periods. At present, we are confident of recovering the approximate cost of this one-time charge under our property and casualty insurance. Notwithstanding this one-time charge, the Company's gross profit margin for the three months ended March 31, 2011 was 41%, compared to a 52% gross profit margin for the three months ended March 31, 2010. Overall, our strong gross margin reflects the direct benefits of actions described above taken by the Company during 2010 and continuing through 2011 to streamline and strengthen of operations and personnel. We continue to efficiently manage our Data Storage Center to plan for growth and capacity without requiring significant capital cost in the short term. Our strategy assumes we will refresh technology every three or four years, so we plan to refresh our hardware technology platform in 2011.

Research and development expenses for the three months ended March 31, 2011 were \$147,853 compared to \$269,742 for the three months ended March 31, 2010. During the first quarter of 2010, we incurred significant expenditures to finalize our in-house product development efforts, which allowed us to bring our new DigiLIBE product to market during the second quarter of 2011. These effort in 2010 allowed us to confirm the stability of the product by enhancing the installation process and broadening the scalability of the product. As a result of these actions, we were able to reduce our research and development overhead and personnel resources during the three months ended March 31, 2011, thus lowering our actual expenditures when compared to the three months ended March 31, 2010.

Given the release and roll-out of our new DigiLibe product in the first quarter of 2010, we have incurred lower sales and marketing expenses for the three months ended March 31, 2011 of \$143,065 compared to \$214,664 incurred during the three months ended March 31, 2010. This decrease in sales and marketing expenditure directly relates to our DigiLibe market launch actions during 2010, which include; establishment of regional and national reseller processes and agreements, and retaining a public relations and industry trade group to create market and industry awareness through product promotion within the industry analyst community, trade publications, and target market segments.

Our general and administrative expenses were reduced 21% from \$458,631 incurred during the three months ended March 31, 2010 compared to \$363,575 for the three months ending March 31, 2011. The improvement is attributable to our conscious efforts to slash costs and streamline administration and reduce executive salaries. The business restructuring undertaken midway through 2010 resulted in targeted efforts to reduce general overhead expenses through personnel realignment to priorities and goals, vendor contract negotiations, stock based compensation alternatives, insurance costs and a daily/weekly focus on expenditures between the CEO and CFO.

The decrease of \$152,603 in interest expense between the comparative three months ended March 31, 2011 and March 31, 2010 is attributed to the amount of convertible notes that were converted under the terms of the Incentive Offer and no longer require the accrual of interest. The loss on extinguishment of debt results from the Company's repayment of a \$100,000 note satisfied through the conversion of the note into the Company's Secured Convertible Debt Offering (see Note 4 to the consolidated financial statements).

---

## [Table of Contents](#)

### **Off-Balance Sheet Arrangements**

We had no off-balance sheet arrangements during 2011 and 2010.

### **Item 4. Controls and Procedures.**

#### **Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities and Exchange Commission reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Our disclosure controls and procedures are also designed to accumulate and communicate information to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. Accordingly, management must apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We conducted our evaluation under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15(b) under the Exchange Act as of the end of the period covered by this report. Based on their review of our disclosure controls and procedures, the Chief Executive Officer and the Chief Financial Officer have concluded that our disclosure controls and procedures are not effective in providing reasonable assurance that information required to be disclosed by us in the reports we file under the Exchange Act were recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules, regulations and forms. In particular, we have identified the following material weakness in our disclosure controls:

(a) We did not maintain sufficient personnel with an appropriate level of technical accounting knowledge, experience, and training in the application of generally accepted accounting principles commensurate with our complexity and our financial accounting and reporting requirements. We have limited experience in the areas of financial reporting and disclosure controls and procedures. As a result, there is a lack of monitoring of the reporting process and there is a reasonable possibility will not be detected or made known to permit us to report on a timely basis.

---

[Table of Contents](#)

**Changes in internal control over financial reporting**

Our management, with the participation of our chief executive officer and chief financial officer, has concluded there were no significant changes in our internal controls over financial reporting that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II — OTHER INFORMATION**

**Item 1. Legal Proceedings.**

None.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3. Defaults Upon Senior Securities.**

As of May 23, 2011, the Company had \$280,020 of debt and accrued interest outstanding from the \$5.5 million offering and \$124,933 of debt and accrued interest outstanding from the \$750,000 secured offering. This debt is presently due and payable.

**Item 6. Exhibits.**

We have listed the exhibits by numbers corresponding to the Exhibit Table of Item 601 in Regulation S-K on the Exhibit list attached to this report.

---

[Table of Contents](#)

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized

**Digitiliti, Inc.**

*Date: May 23, 2011*

By: /s/ Ehssan Taghizadeh  
*Ehssan Taghizadeh, President, CEO*  
(Principal Executive Officer)

*Date: May 23, 2011*

By: /s/ William McDonald  
*William McDonald, CFO*  
(Principal Accounting Officer)

[Table of Contents](#)

**INDEX TO EXHIBITS**

<u>Exhibit No.</u>	<u>Description of Exhibit</u>
31.1	302 Certification of CEO, Ehssan Taghizadeh
31.2	302 Certification of CFO, William McDonald
32.1	906 Certification
99.1	Settlement Agreement and Release dated March 8, 2010 (incorporated by reference to Exhibit 99.1 to the registrant's Current Report on Form 8-K filed with the Commission on March 23, 2010).
10.1	Form of Convertible Promissory Note and Warrant Purchase Agreement dated as of February 28, 2011
10.2	Form of Secured Convertible Promissory Note dated as of February 28, 2011
10.3	Form of Security Agreement
10.4	Form of Warrant Agreement
10.5	Form of Repayment of Miner Note Obligations and Release of Miner Security Interest Agreement



<DOCUMENT>  
<TYPE> EX-10.1  
<FILENAME> c17782exv10w1.htm  
<DESCRIPTION> EX-10.1  
<TEXT>

**DIGITILITI, INC.**  
**CONVERTIBLE PROMISSORY NOTE AND WARRANT PURCHASE AGREEMENT**

THIS CONVERTIBLE PROMISSORY NOTE AND WARRANT PURCHASE AGREEMENT (this "**Agreement**") is made as of February \_\_\_\_\_, 2011, by and among Digitiliti, Inc., a Delaware corporation (the "**Company**"), and the investors listed on Exhibit A (each, an "**Investor**" and collectively, the "**Investors**").

A. The Company is in need of capital in order to repay an outstanding promissory note issued by the Company in original principal amount of \$531,540, plus accrued interest of \$\_\_\_\_\_ as of \_\_\_\_\_, 2011 for an aggregate total of \$\_\_\_\_\_ (the "**Outstanding Note**"), the holders of which have agreed to accept the amount of \$531,540 in cash, plus other good and valuable consideration (the "**Repayment Amount**") as full repayment of the Outstanding Note.

B. The Investors are willing to lend the Company the Repayment Amount pursuant to the terms and conditions set forth below.

The parties hereby agree as follows:

**1. Definitions.**

1.1 "**Bylaws**" means the bylaws of the Company as in effect as of the date hereof.

1.2 "**Certificate of Incorporation**" means the Certificate of Incorporation of the Company as in effect as of the date hereof.

1.3 "**Commission**" means the U.S. Securities and Exchange Commission or any similar agency then having jurisdiction to enforce the Securities Act.

1.4 "**Common Stock**" means Common Stock, par value \$0.001 per share, of the Company, or any other capital stock of the Company into which such stock is reclassified or reconstituted.

1.5 "**Governmental Authority**" means the government of any nation, state, city, locality or other political subdivision thereof, any entity exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to government, and any corporation or other entity owned or controlled, through stock or capital ownership or otherwise, by any of the foregoing.

1.6 "**Majority Noteholders**" means holders of more than 50% in principal amount of the outstanding Notes.

1.7 "**Note Securities**" means the Common Stock issuable upon conversion of the Notes.

1.8 "**Person**" means any individual, firm, corporation, partnership, trust, incorporated or unincorporated association, joint venture, joint stock company, limited liability company, Governmental Authority or other entity of any kind, and shall include any successor (by merger or otherwise) of such entity.

1.9 “**Requirement of Law**” means, as to any Person, any law, statute, treaty, rule, regulation, license or franchise or determination of an arbitrator or a court or other Governmental Authority, in each case applicable or binding upon such Person or any of its property or to which such Person or any of its property is subject or pertaining to any or all of the transactions contemplated or referred to herein.

1.10 “**Security Agreement**” means the Security Agreement by and between the Company, the Investors and the Collateral Agent dated as of the date hereof and attached hereto as Exhibit D.

1.11 “**Securities**” means the Notes, Warrants, Note Securities and Warrant Securities.

1.12 “**Securities Act**” means the Securities Act of 1933, as amended, and the rules and regulations of the Commission thereunder.

1.13 “**Transaction Documents**” means collectively, this Agreement, the Notes, the Warrants and the Security Agreement.

1.14 “**Warrant Securities**” means the Common Stock issuable upon exercise of the Warrants.

## **2. Purchase and Sale of Notes and Warrants.**

### **2.1 Authorization and Sale of Notes and Warrants.**

(a) Notes. The Company has authorized the issuance and sale to the Investors of Secured Convertible Promissory Notes in the form attached hereto as Exhibit B in the initial aggregate principal amount of \$1,000,000 for an aggregate purchase price of \$1,100,000 (a discount of 10%, collectively referred to as the “**Notes**” and individually as a “**Note**”). At the Company’s discretion, said aggregate principal amount of the Secured Convertible Promissory Notes can be increased up to \$1,200,000 for an aggregate purchase price of \$1,320,000 (again reflecting a discount of 10%). The repayment of the Notes will be secured by a security interest in all of the Company’s assets pursuant to the Security Agreement; provided, however, each Investor hereby agrees and acknowledges that the security interest granted to the Investors securing repayment of the Notes is expressly subordinate to the loan secured by a first security interest in the Company’s Vault in the original principal amount of \$100,000 (the “**Vault Loan**”) and Permitted Indebtedness (as set forth in Schedule 3.8) and as permitted by Section 7. Upon the occurrence of any event of default under the Vault Loan, each Investor shall have the right to purchase a new note in principal amount equal to its pro rata portion (based upon the total outstanding principal amount of all Notes) of the Vault Loan plus any accrued interest. In the event that an Investor does not purchase a note representing all of his, her or its pro rata portion of the Vault Loan, then the Investors who have so elected to purchase their respective pro rata portions shall have the option to purchase additional notes in the principal amount equal to their respective pro rata portion (as among all holders of Notes who elect to purchase the new notes) of the remaining balance of the Vault Loan plus any accrued interest. The Company shall issue a new Secured Convertible Promissory Note to each such participating Investor and the Company will use the proceeds from the sale of such notes to repay the Vault Loan including accrued interest. Each such new Secured Convertible Promissory Note shall have the same terms as the Notes and shall be treated as issued hereunder.

(b) Warrants. Based on the initial aggregate principal amount of \$1,000,000, the Company has authorized the issuance and sale to the Investors of Warrants in the form attached hereto as Exhibit C to purchase in the aggregate 2,500,000 shares of Common Stock (collectively referred to as the “**Warrants**” and individually as a “**Warrant**”). Should the Company increase the aggregate principal amount of the Secured Convertible Promissory Notes to \$1,200,000, the Company shall authorize the issuance and sale of Warrants to the Investors to reflect an aggregate total of 3,000,000 shares of Common Stock (collectively referred to as the “**Warrants**” and individually as a “**Warrant**”).

(c) Purchase Price. Subject to the terms and conditions of this Agreement, each Investor agrees, severally and not jointly, to pay the Company at the Closing the purchase price for such Investor’s Note and Warrant in the amount set forth opposite the Investor’s name on Exhibit A in the column headed “Total Purchase Price.” The Company agrees to sell and issue to each Investor at the Closing a Note in the original principal amount as set forth opposite the Investor’s name on Exhibit A. An Investor’s purchase price for the Warrants shall be the product of .001 multiplied by the principal amount of such Investor’s Note.

2.2 Closing. The closing of the purchases and sales of the Notes and Warrants (the “**Closing**”) shall take place at the offices of Winthrop & Weinstine, P.A., Suite 3500, 225 South 6<sup>th</sup> Street, Minneapolis, Minnesota 55402-4629, by an exchange of executed counterpart copies of this Agreement, other Transaction Documents and the other closing documents. At the Closing, the Company shall deliver to each Investor a Note and Warrant as well as an executed original of the Security Agreement and this Agreement and each Investor will deliver an executed original of this Agreement and any other closing documents and will pay the purchase price for the Note and the Warrant to the Company in immediately available funds.

**3. Representations and Warranties of the Company.** The Company represents and warrants to the Investors as follows:

3.1 Corporate Existence and Power. The Company is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware, has all requisite power and authority to own and operate its property, to lease the property it operates as lessee and to conduct the business in which it is currently engaged, and has the corporate power and authority to execute, deliver, and perform its obligations under each of the Transaction Documents except as such enforceability may be limited by general principles of equity or applicable bankruptcy, insolvency, reorganization, moratorium, liquidation or similar laws relating to, or affecting generally, the enforcement of applicable creditors’ rights and remedies and except as rights to indemnification and to contribution may be limited by federal or state securities law. The Company is duly qualified to do business as a foreign corporation and is in good standing under the laws of each state or other jurisdiction in which either the ownership or use of the properties owned or used by it, or the nature of the activities conducted by it, requires such qualification except to the extent that the failure to be so qualified would not have a material adverse effect.

3.2 Authorization; No Contravention. The execution, delivery and performance by the Company of each of the Transaction Documents and the transactions contemplated thereby, including, without limitation, the sale, issuance and delivery of the Securities, have been duly authorized by all necessary corporate action of the Company, do not contravene the terms of the Certificate of Incorporation or the Bylaws, or any amendment thereof, do not violate, conflict with or result in any breach or contravention of, or the creation of any lien, mortgage, security interest, or similar encumbrance under, any contractual obligation of the Company, or any Requirement of Law applicable to the Company, and do not violate any judgment, injunction, writ, award, decree or order of any nature (collectively, “**Orders**”) of any Governmental Authority against, or binding upon the Company. The Company has not previously entered into any contractual obligation which is currently in effect or by which it is currently bound, granting any rights to any Person which are inconsistent with the rights to be granted by the Company in any of the Transaction Documents.

3.3 Government Authorization; Third-Party Consents. Other than customary federal and state filings necessary in connection with the claiming of exemptions from registration of the issuance of the Securities contemplated hereby, and except as otherwise set forth in the Transaction Documents, no approval, consent, compliance, exemption, authorization, or other action by, or notice to, or filing with, any Governmental Authority or any other Person in respect of any Requirement of Law, or any contractual obligation of the Company, and no lapse of a waiting period under a Requirement of Law, or any contractual obligation of the Company, is necessary or required in connection with the execution, delivery or performance (including, without limitation, the sale, issuance and delivery of the Securities) by, or enforcement against the Company, of any of the Transaction Documents.

3.4 Binding Effect. Each of the Transaction Documents has been duly authorized, executed, and delivered by the Company and constitutes the legal, valid and binding obligations of the Company enforceable against the Company in accordance with its terms.

3.5 Litigation. Except as set forth on Schedule 3.5, there are no actions, suits, proceedings, claims, complaints, disputes, arbitrations or investigations pending or, to the knowledge of the Company, threatened, at law, in equity, in arbitration or before any Governmental Authority against the Company. Except as set forth on Schedule 3.5, there is no fact, event, or circumstance known to the Company that is reasonably likely to give rise to any claim that would be required to be set forth as an exception to the representation set forth in the preceding sentence if currently pending or threatened. No Order has been issued by any court or other Governmental Authority against the Company purporting to enjoin or restrain the execution, delivery or performance of any of the Transaction.

3.6 No Defaults. Except as set forth on Schedule 3.6, the Company is not in material violation or breach of, or in material default under any note, indenture, mortgage, lease, contract, purchase order or other instrument, document or agreement to which the Company is a party or by which it or any of its property is bound or affected or any ruling, writ, injunction, order, judgment or decree of any court, administrative agency or other governmental body which violation, breach or default would have a material adverse effect on the financial condition, results of operations, assets, liabilities, business or prospects of the Company, and to the Company's knowledge, there exists no condition, event or act which after notice, lapse of time, or both, may constitute a material violation or breach of, or a material default under, any of the foregoing which violation, breach or default would have a material adverse effect on the financial condition, results of operations, assets, liabilities, business or prospects of the Company.

3.7 Taxes. There are no federal, state, county, local or foreign taxes due and payable by the Company which have not been timely paid. There are no accrued and unpaid federal, state, county, local or foreign taxes of the Company which are due, whether or not assessed or disputed. There have been no examinations or audits of any tax returns or reports by any applicable federal, state, local or foreign governmental agency. The Company has duly and timely filed all federal, state, county, local and foreign tax returns required to have been filed by it and there are in effect no waivers of applicable statutes of limitations with respect to taxes for any year.

3.8 No Liens or Encumbrances. Other than as set forth on Schedule 3.8 (the “**Permitted Indebtedness**”), the property and assets that the Company owns are free and clear of all mortgages, deeds of trust, liens, loans and encumbrances, except for statutory liens for the payment of current taxes that are not yet delinquent and encumbrances and liens that arise in the ordinary course of business and do not materially impair the Company’s ownership or use of such property or assets.

3.9 SEC Reports. The Company has filed all forms, reports and documents required to be filed by the Company with the Commission. Except as set forth on Schedule 3.9, all such required forms, reports and documents (including those that the Company may file subsequent to the date hereof) are referred to herein as the “**SEC Reports**”). As of their respective dates, the SEC Reports (a) were prepared in accordance and complied in all material respects with the requirements of the Securities Act or the Securities Exchange Act of 1934, as amended, as the case may be, and the rules and regulations of the Commission thereunder applicable to such SEC Reports and (b) did not at the time they were filed contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading.

3.10 Compliance with Laws. The Company has, to its knowledge, complied in all material respects with, is not in material violation of, and has not received any written notices of violation with respect to, any Requirement of Law with respect to the conduct of its business, or the ownership or operation of its assets or properties.

3.11 Private Offering. No form of general solicitation or general advertising was used by the Company or its representatives in connection with the offer or sale of the Securities. Assuming that the representations of the Investors set forth in Section 4 hereof are true, no registration of the Securities, pursuant to the provisions of the Securities Act or any state securities or “blue sky” laws, will be required by the offer, sale or issuance of the Securities. The Company agrees that neither it, nor anyone acting on its behalf, shall offer to sell the Securities or any other security of the Company so as to require the registration of the Securities pursuant to the provisions of the Securities Act or any state securities or “blue sky” laws, unless such Securities or other security is so registered.

3.12 Broker’s, Finder’s or Similar Fees. As of the date of the Closing, there are no brokerage commissions, finder’s fees or similar fees or commissions payable by the Company in connection with the transactions contemplated hereby based on any agreement, arrangement or understanding with the Company or any action taken by any such Person except as set forth on Schedule 3.12.

**4. Representations and Warranties of the Investors**. Each Investor, severally and not jointly with any other Investor, hereby represents and warrants to the Company that:

4.1 Existence and Power. The Investor has the requisite power and authority to execute, deliver and perform its obligations under each of the Transaction Documents to which it is a party.

4.2 Accredited Investor Status. The Investor is an “accredited investor” as that term is defined by Rule 501 of Regulation D promulgated under the Securities Act and is a resident of the state or other jurisdiction set forth opposite such Investor’s name on the Exhibit A.

4.3 Broker’s, Finder’s or Similar Fees. There are no brokerage commissions, finder’s fees or similar fees or commissions payable by the Investor in connection with the transactions contemplated hereby based on any agreement, arrangement or understanding with the Investor or any action taken by the Investor.

4.4 Purchase Entirely for Own Account. The Investor hereby confirms, that the Securities to be acquired by the Investor will be acquired for investment for the Investor's own account, not as a nominee or agent, and not with a view to the resale or distribution of any part hereof, and that the Investor has no present intention of selling, granting any participation in, or otherwise distributing the same. By executing this Agreement, the Investor further represents that the Investor does not presently have any contract, undertaking, agreement, or arrangement with any person to sell, transfer, or grant participation to such person or to any third person, with respect to any of the Securities. The Investor has not been formed for the specific purpose of acquiring the Securities.

4.5 Disclosure of Information. The Investor has had an opportunity to discuss the Company's business, management, financial affairs, and the terms and conditions of the offering of the Notes and Warrants with the Company's management and has had an opportunity to inspect the Company's facilities and has utilized such access to the Investor's satisfaction.

4.6 Speculative Securities. The Investor understands that an investment in the Securities is highly speculative and involves a high degree of risk. The Investor believes the investment is suitable for the Investor based on his, her or its investment objectives and financial needs. The Investor has adequate means for providing for his, her or its current financial needs and personal contingencies and has no need for liquidity of investment with respect to the Securities. The Investor can bear the economic risk of investment in the Securities for an indefinite period of time and can afford a complete loss of such investment.

4.7 Restricted Securities. The Investor understands that the Securities have not been registered under the Securities Act by reason of a specific exemption from the registration provisions of the Securities Act which depends upon, among other things, the bona fide nature of the investment intent and the accuracy of the Investor's representations as expressed in this Agreement. The Investor understands that the Securities are "restricted securities" under applicable U.S. federal and state securities laws and that, pursuant to these laws, the Investor must hold the Securities indefinitely unless they are registered with the Commission and qualified by state authorities, or an exemption from such registration and qualification requirements is available. The Investor acknowledges that the Company has no obligation to register or qualify the Securities for resale. The Investor further acknowledges that if an exemption from registration or qualification is available, it may be conditioned on various requirements, including but not limited to, the time and manner of sale, the holding period for the Securities, and on requirements relating to the Company which are outside of the Investor's control, and which the Company is under no obligation and may not be able to satisfy.

4.8 No Public Market. The Investor understands that a very limited public market exists for the Common Stock, but no market exists for any other securities issued by the Company, and that the Company has made no assurances that a public market will ever exist for the Securities. Accordingly, Investor understands that he, she or it must hold the Securities indefinitely and may never be able to resell them for their original purchase price, or at all, and thus may lose his, her or its entire investment in the Company.

4.9 Legends. The Investor understands that the Securities and any securities issued in respect of or exchange for the Securities may bear one or both of the following legends:

- (a) THIS SECURITY HAS NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR APPLICABLE BLUE SKY LAWS, AND IS SUBJECT TO CERTAIN INVESTMENT REPRESENTATIONS. THIS SECURITY MAY NOT BE SOLD, OFFERED FOR SALE OR TRANSFERRED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT UNDER THE ACT AND APPLICABLE BLUE SKY LAWS, OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED.
- (b) Any legend required by the blue sky laws of any state to the extent such laws are applicable to the shares represented by the certificate bearing such legend.

## 5. Conditions of Closing.

5.1 Conditions of Investors' Obligations at Closing. The Investors' obligations at Closing will be contingent upon satisfaction or waiver of the following conditions:

(a) Repayment of Outstanding Note. Contemporaneously with the Closing, the Company shall pay the Repayment Amount to the holder of the Outstanding Note.

(b) Termination of Security Interest. At the Closing, the Company shall deliver to the Investors a Release and Written Consent of the holder of the Outstanding Note acknowledging full satisfaction of the Outstanding Note and authorizing the termination of the security interest held by such holders with respect to the Outstanding Note.

(c) Secretary's Certificate. At the Closing, the Company shall deliver to the Investors a certificate, in form and substance satisfactory to the Investors, signed by the Secretary of the Company, certifying (i) that the attached copies of the Certificate of Incorporation, the Bylaws and resolutions of the Board of Directors of the Company approving each of the Transaction Documents and the transactions contemplated thereby, are all true, complete and correct and remain unamended and in full force and effect, and (ii) as to the incumbency and specimen signature of each officer of the Company executing each of the Transaction Document and any other document delivered in connection therewith on behalf of the Company.

(d) Documents. At the Closing, the Company shall have provided to the Investors true, complete, and correct copies of such documents as the Investors may have reasonably requested in connection with or relating to the sale of the Notes and Warrants, the other Transaction Documents, and the transactions contemplated hereby and thereby, all in form and substance reasonably satisfactory to the Investors and the Investors shall have completed their due diligence to the Investors' satisfaction, in their sole discretion, including a detailed review of past financial performance.

(e) Consents and Approvals. At the Closing, except for customary federal and state filings necessary in connection with the claiming of exemptions for the issuance of securities contemplated hereby, which filings will be made at or promptly following the date of this Agreement, all consents, exemptions, authorizations, or other actions by, or notices to, or filings with, Governmental Authorities and other Persons required in respect of all Requirements of Law which are necessary in connection with the execution, delivery or performance by, or enforcement against, the Company of this Agreement and each of the other Transaction Documents shall have been obtained and be in full force and effect.

5.2 Conditions of the Company's Obligations at Closing. The obligations of the Company to each Investor under this Agreement are subject to the fulfillment on or before the Closing of each of the following conditions by that Investor:

(a) Payment of Purchase Price. The Investor shall pay to the Company, or as directed by the Company in writing, the applicable aggregate purchase price of the Note and Warrant and the total amount received from all Investors in immediately available funds equals or exceeds \$700,000.

(b) Receipt of Release and Written Consent. The Company shall have received all required releases and written consents from John and Pam Miner.

(c) Qualifications. All authorizations, approvals or permits, if any, of any governmental authority or regulatory body of the United States or of any state or foreign jurisdiction that are required in connection with the lawful issuance and sale of the Securities at Closing pursuant to this Agreement shall be duly obtained and effective as of the Closing.

**6. Indemnification.** The Company agrees to indemnify and hold harmless each Investor and its successors and assigns, together with any of their officers, directors, or shareholders (such persons, the "**Indemnified Parties**"), from and against any and all losses, damages, liabilities, obligations, costs or expenses (any one such item being herein called a "**Loss**" and all such items being herein collectively called "**Losses**") which are caused by or arise out of, or (in the case of claims asserted against any Indemnified Parties by a third party) alleged to result from, arise out of or have been incurred with respect to, (a) any material breach or default in the performance by the Company of any covenant or agreement of the Company contained in this Agreement, (b) any material breach of warranty or inaccurate or erroneous representation made by the Company herein or in any certificate or other instrument delivered by or on behalf of the Company pursuant hereto, and (c) any and all material actions, suits, proceedings, claims, demands, judgments, costs and expenses (including costs and reasonable hourly attorneys' fees) arising out of the foregoing except when such actions, suits, proceedings, claims, demands, judgments, costs and expenses arise as a result of the grossly negligent or intentional actions or omissions of any Investor. Except for Losses caused by or arising out of the gross negligence or willful misconduct of the Company, any Losses resulting from (a) or (b) under this Agreement shall be limited to the actual amount invested pursuant to this Agreement.

**7. Negative Covenant.** Except as set forth in Sections 2.1 and 7 or Permitted Indebtedness, for so long as the Notes remain outstanding, the Company will not, without the prior written consent of the Majority Noteholders, create or suffer to exist any debt that is or that purports to have a security interest in or to the assets of the Company that is senior to the security interest held by the Investors with respect to the Notes. For the avoidance of doubt, consent pursuant to this provision shall be consent to any other similar prohibition included in the Notes or Security Agreement. The Investors shall, from time to time, at the request of the Company, subordinate the portion of the security interest securing repayment of the Notes covering accounts receivable only to any accounts receivable or equipment based financing obtained by the Company from any bank or other lender.

[E/O]

CRC: 18120  
EDGAR 2

BPC C17782 710.01.09.00 0/1  


**8. Affirmative Covenants.** For so long as the Notes remain outstanding, the Company shall use its best efforts to timely file all reports which it is required to file with the Commission. If the Company fails to do so, it shall promptly provide the Investors with the same financial statements, in unaudited form, as would be required to be included in such reports.

**9. Miscellaneous.**

9.1 Survival. The warranties and representations of the Company and the Investors and the indemnification obligations of each party contained in or made pursuant to this Agreement shall survive the execution and delivery of this Agreement and the Closing and shall in no way be affected by any investigation of the subject matter thereof made by or on behalf of the Investors or the Company.

9.2 Expenses. The Company and the Investors shall each pay their own expenses in connection with the transactions contemplated by this Agreement.

9.3 Successors and Assigns. Except as otherwise provided herein, the terms and conditions of this Agreement shall inure to the benefit of and be binding upon the respective successors and assigns of the parties (including permitted transferees of any Securities). Nothing in this Agreement, express or implied, is intended to confer upon any party, other than the parties hereto or their respective successors and assigns, any rights, remedies, obligations or liabilities under or by reason of this Agreement, except as expressly provided in this Agreement.

9.4 Governing Law. This Agreement shall be governed by and construed under the substantive laws of the State of Minnesota, without regard to the conflicts of law provisions thereof, as applied to agreements among Minnesota residents entered into and to be performed entirely within Minnesota.

9.5 Titles and Subtitles. The titles and subtitles used in this Agreement are used for convenience only and are not to be considered in construing or interpreting this Agreement.

9.6 Notices. All notices, requests, demands, approvals, consents, and other communications which are required or may be given hereunder shall be (a) in writing; (b) addressed to the parties as set forth below, unless a party notifies the others of a change of address (in which case the latest noticed address shall be used); and (c) deemed to have been duly given (i) on the date given by hand delivery or facsimile, or (ii) the day after deposit with a recognized overnight courier; provided that if the actual or deemed notice date is not a business day, the date of actual or deemed notice shall be the next business day thereafter:

If to the Investors, to the addresses set forth for the Investors on Exhibit A, with a copy to:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Minneapolis, MN \_\_\_\_\_  
Attn: \_\_\_\_\_, Esq.  
Fax No.: (\_\_\_\_\_) \_\_\_\_\_ - \_\_\_\_\_

If to the Company:

Digitiliti, Inc.  
266 East 7th Street  
Saint Paul, MN 55101  
Attn: Chief Executive Officer  
Fax No.: (651) 925-3232

with a copy to:

Winthrop & Weinstine, P.A.  
Capella Tower, Suite 3500  
225 South Sixth Street  
Minneapolis, MN 55402  
Attn: Philip T. Colton, Esq.  
Fax No.: (612) 604-6929

9.7 Amendments and Waivers. Any term of this Agreement or any of the other Transaction Documents may be amended and the observance of any term of this Agreement may be waived (either generally or in a particular instance and either retroactively or prospectively), only with the written consent of the Company and the Majority Noteholders. Any amendment or waiver effected in accordance with this Section 9.7 shall be binding upon each holder of any Securities purchased under this Agreement at the time outstanding and each future holder of all such Securities and the Company.

9.8 Severability. If one or more provisions of this Agreement are held to be unenforceable under applicable law, such provision shall be excluded from this Agreement and the balance of the Agreement shall be interpreted as if such provision were so excluded and shall be enforceable in accordance with its terms.

9.9 Entire Agreement. The Transaction Documents and the other documents referred to herein constitute the entire agreement among the parties with respect to the matters addressed herein and no party shall be liable or bound to any other party in any manner by any warranties, representations or covenants except as specifically set forth therein.

9.10 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

9.11 Acknowledgement Among Investors. Each Investor acknowledges, as to itself, that such Investor is not relying upon any person, firm or corporation, other than the written representations and warranties of the Company and its officers, in making its investment or decision to invest in the Company. Each Investor agrees that no other Investor (or their respective controlling persons, officers, directors, partners, agents or employees) shall be liable for any action taken or omitted to be taken in connection with the sale of the Notes and Warrants.

[SIGNATURE PAGES FOLLOW]

[E/O]

CRC: 35590  
EDGAR 2

**BPC C17782 710.01.11.00 0/1**  


---

**IN WITNESS WHEREOF**, the parties have executed this Convertible Promissory Note and Warrant Purchase Agreement as of the date first above written.

**THE COMPANY:**

DIGITILITI, INC.  
a Delaware corporation

By: \_\_\_\_\_

Name: \_\_\_\_\_

Its: \_\_\_\_\_

[COMPANY SIGNATURE PAGE TO CONVERTIBLE PROMISSORY NOTE  
AND WARRANT PURCHASE AGREEMENT]

[MULTIPLE INVESTOR SIGNATURE PAGES FOLLOW]

**DIGITILITI, INC.**

**INVESTOR SIGNATURE PAGE TO  
CONVERTIBLE PROMISSORY NOTE AND WARRANT PURCHASE AGREEMENT**

The undersigned (the "**Investor**") has read and understands the Convertible Promissory Note and Warrant Purchase Agreement between Digitiliti, Inc. (the "**Company**") and certain investors, dated \_\_\_\_\_, 2011 (the "**Purchase Agreement**"). The Investor wishes to become a party to the Purchase Agreement and purchase \$\_\_\_\_\_ of Notes pursuant to the terms thereof. Upon the Investor signing in the space provided below and the Company's acceptance hereof, the Investor shall be a party to the Purchase Agreement.

**INDIVIDUAL INVESTOR:**

Signature: \_\_\_\_\_

Name: \_\_\_\_\_

Address: \_\_\_\_\_

**ENTITY INVESTOR:**

\_\_\_\_\_

Signature: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Address: \_\_\_\_\_

**EXHIBIT A**

**SCHEDULE OF INVESTORS**

<u>Name</u>	<u>Principal Amount of Note[110% of Purchase Price]</u>	<u>Discount Purchase Price for Note</u>	<u>Warrants</u>	<u>Warrant Purchase Price</u>	<u>Total Purchase Price</u>	<u>State of Residence</u>
-------------	---	---	-----------------	---------------------------------------	-------------------------------------	---------------------------

**[E/O]**

CRC: 46895  
**EDGAR 2**

**BPC C17782 710.01.14.00 0/1**  


---

**EXHIBIT B**

**FORM OF SECURED CONVERTIBLE PROMISSORY NOTE**

**[E/O]**

CRC: 41272  
**EDGAR 2**

**BPC C17782 710.01.15.00 0/1**  


---

**EXHIBIT C**  
**FORM OF WARRANT**

**[E/O]**

CRC: 41799  
**EDGAR 2**

**BPC C17782 710.01.16.00 0/1**  


---

**EXHIBIT D**

**FORM OF SECURITY AGREEMENT**



<DOCUMENT>  
<TYPE> EX-10.2  
<FILENAME> c17782exv10w2.htm  
<DESCRIPTION> EX-10.2  
<TEXT>

**THIS SECURITY HAS NOT BEEN REGISTERED UNDER EITHER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR APPLICABLE BLUE SKY LAWS, AND IS SUBJECT TO CERTAIN INVESTMENT REPRESENTATIONS. THIS SECURITY MAY NOT BE SOLD, OFFERED FOR SALE OR TRANSFERRED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION UNDER THE ACT AND APPLICABLE BLUE SKY LAWS, OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED.**

**DIGITILITI, INC.**

**SECURED CONVERTIBLE PROMISSORY NOTE**

\$ \_\_\_\_\_, 2011

FOR VALUE RECEIVED, Digitiliti, Inc., a Delaware corporation (the "**Company**"), promises to pay to the order of \_\_\_\_\_, a [insert state of residence /insert entity form, organized and existing under the laws of \_\_\_\_\_] or [his/her/its] successors and assigns (the "**Holder**"), at \_\_\_\_\_, or at such other place designated at any time by the Holder hereof, in lawful money of the United States of America and in immediately available funds, the principal sum \$ \_\_\_\_\_, or so much thereof as may be outstanding from time to time, together with interest thereon as set forth herein. This Secured Convertible Promissory Note (this "**Note**") is one of several notes (collectively, the "**Notes**") being issued by the Company pursuant to that certain Convertible Promissory Note and Warrant Purchase Agreement dated as of February \_\_\_\_\_, 2011 (the "**Purchase Agreement**"). Each of the Notes shall be identical to the other Notes except with respect to the principal amount and the name of and other information regarding the holder. Capitalized terms used but not otherwise defined herein, shall have the meanings given to them in the Purchase Agreement.

**1. Definitions.** For purposes of this Note, the following terms shall have the definitions set forth below:

- (a) "**Conversion Price**" means \$0.20 per share of Common Stock.
- (b) "**Majority Holders**" means the holders of more than 50% in principal amount of the outstanding Notes.
- (c) "**Maturity Date**" means August 1, 2012, as such date may be extended pursuant to Section 2 hereof.
- (d) "**Pro Rata Portion**" with respect to a Holder, means such Holder's percentage holding of the aggregate principal amount of all outstanding Notes.

**2. Maturity.** The entire outstanding principal balance of this Note, together with all accrued and unpaid interest thereon (the "**Outstanding Balance**"), shall be due and payable on the Maturity Date. The Company may extend the Maturity Date of all outstanding Notes (but not less than all Notes) for up to two six-month periods, provided that each time the Company elects to extend the Maturity Date the Company shall issue to the Holder a warrant to purchase that number of shares of Common stock equal to the product of (a) such Holder's Pro Rata Portion and (b) 577,500 (rounded down to the nearest whole number). Such warrant shall have the same terms as the Warrants, but shall have an exercise price equal to 110% of the average closing market price for the ten trading days before the date of issuance.

**3. Interest.** This Note shall bear interest on the outstanding principal amount at the rate of 12% per annum simple interest (or if this rate exceeds the maximum rate permissible by law, the maximum rate permissible) until the Note is paid in full. Interest on this Note may be prepaid at any time, without penalty.

**4. Security Interest.** Except as set forth in Section 5 or for Permitted Indebtedness (as defined in the Purchase Agreement), this Note is secured by all of the assets of the Company pursuant to the terms of the Security Agreement. The payment of this Note shall rank equal in right of payment to each of the other Notes.

**5. Subordination.** The Holder hereby agrees and acknowledges that the security interest granted to the Holder securing repayment of this Note is expressly subordinate to the Vault Loan (as such term is defined in the Purchase Agreement). Additionally, the Holder shall, from time to time, at the request of the Company, subordinate the portion of the security interest securing repayment of this Note (and all Notes) covering accounts receivable only to any accounts receivable or equipment based financing obtained by the Company from any bank or other lender.

**6. Prepayment.** Upon notice of prepayment, the Holder shall have ten business days to elect, in the Holder's sole discretion, to either (i) convert the Note pursuant to Section 7(a) or (ii) be repaid the Outstanding Balance. Any cash payments made by the Company with regard to any of the Notes will be made simultaneously with regard to all of the Notes, other than Notes converted at the request of the Holder thereof, in an amount prorated among the Notes in proportion to the outstanding principal balances of each of the Notes.

**7. Conversion.**

(a) The Holder shall have the right at any time to convert the Outstanding Balance into that number of shares of Common Stock found by dividing the Outstanding Balance by the Conversion Price.

(b) If the closing price of the Company's Common Stock is \$1.00 or higher for 20 consecutive trading days, the Company may in its sole discretion, convert all outstanding Notes (and not less than all Notes). If the Company elects to convert the Notes into Common Stock pursuant to this Section 7(b) and the Holder does not elect to have all amounts due hereunder paid in cash within forty-five business days of the notice of conversion: (i) this Note shall convert into that number of shares of Common Stock found by dividing the applicable Outstanding Balance by the Conversion Price, and (ii) if the shares are not then freely tradeable under Rule 144, the Company shall use reasonable efforts to register the underlying shares with the Commission as soon as reasonably practicable.

(c) Upon any conversion of this Note described in Section 7(a) or (b), the Holder shall immediately surrender this Note (or a portion of this Note, as applicable) in exchange for stock certificates representing the appropriate number of shares of Common Stock, the number of which shall be rounded up to the nearest whole number, such that no fractional shares shall be issued.

**8. Events of Default and Acceleration.** Any part or all of the then Outstanding Balance shall become immediately due and payable upon the occurrence of an Event of Default unless such Event of Default is cured within 30 days of written notice from the Majority Holders or an agent thereof the occurrence of any of the following events of default (each an “Event of Default”):

(a) the Company fails to make the payment of principal or interest of the Note when the same becomes due and payable; or

(b) the Company materially breaches any term of this Note or any term of the other Transaction Documents (as defined in the Purchase Agreement); or

(c) the Company shall generally fail to pay, or admit in writing its inability to pay, its debts as they become due; or

(d) the Company shall cease or materially diminish its operation, or apply for, consent to, or acquiesce in the appointment of a trustee, receiver or other custodian for itself or any of its property, or make a general assignment composition, or similar device for the benefit of its creditors; or a trustee, receiver or other custodian shall otherwise be appointed for the Company or any of its assets; an attachment or receivership of assets or any bankruptcy, reorganization, debt arrangement, or other case or proceeding under any bankruptcy or insolvency law, or any dissolution or liquidation proceeding shall be commenced by or against the Company; or the Company shall take any corporate action to authorize, or in furtherance of, any of the foregoing.

**9. Attorneys’ Fees.** If the principal and interest on this Note is not paid when due, whether or not collection is initiated by the prosecution of any suit, or by any other judicial proceeding, or this Note is placed in the hands of an attorney for collection, the Company shall pay, in addition to all other amounts owing hereunder, all costs expenses and fees, including reasonable hourly attorneys’ fees, incurred by the Holder in connection therewith.

**10. Waiver and Consent.** The Company hereby waives presentment for payment, notice of nonpayment, protest, notice of protest and all other notices, filing of suit and diligence in collecting the amounts due under this Note and agrees that the Holder shall not be required first to initiate any suit or exhaust its remedies against any other person or parties in order to enforce payment of this Note.

**11. Governing Law.** This Note shall be governed by and construed in accordance with the laws of the State of Minnesota, without regard to conflict of laws provisions.

**12. Miscellaneous Provisions.** This Note shall be binding on the successors and assigns of the Company and inure to the benefit of the Holder, its successors, endorsees and assigns. Wherever possible, each provision of this Note shall be interpreted in such manner as to be effective and valid under applicable law, but if any provision of this Note shall be prohibited by or invalid under applicable law, such provision shall be ineffective only to the extent of such prohibition or invalidity, without invalidating the remainder of such provision or the remaining provisions of this Note. This Note may be changed only by an agreement in writing signed by the Company and the Holder.

IN WITNESS WHEREOF the undersigned have executed this Note effective as of the date first above written.

**COMPANY:**

**DIGITILITI, INC.**

By: \_\_\_\_\_

Name: \_\_\_\_\_

Its: \_\_\_\_\_

**INDIVIDUAL HOLDER:**

Signature: \_\_\_\_\_

Name: \_\_\_\_\_

**ENTITY HOLDER:**

By: \_\_\_\_\_

Name: \_\_\_\_\_

Its: \_\_\_\_\_

[Signature Page to Secured Convertible Promissory Note]



<DOCUMENT>  
<TYPE> EX-10.3  
<FILENAME> c17782exv10w3.htm  
<DESCRIPTION> EX-10.3  
<TEXT>

## SECURITY AGREEMENT

This Security Agreement ("**Agreement**") is made as of February \_\_\_\_\_, 2011 by and among Digitiliti, Inc., a Delaware corporation (the "**Debtor**"), and the parties listed on Schedule A (each a "**Secured Party**", and collectively the "**Secured Parties**"), and the Collateral Agent (as defined herein) on behalf of the Secured Parties.

A. The Secured Parties have purchased and the Debtor has issued secured convertible promissory notes in the initial aggregate principal amount of \$1,100,000 (the "**Notes**") pursuant to that certain Convertible Promissory Note and Warrant Purchase Agreement (the "Purchase Agreement"). At the Company's discretion, said aggregate principal amount of the secured convertible promissory notes can be increased up to \$1,200,000 for an aggregate purchase price of \$1,320,000 (again reflecting a discount of 10%).

B. Each Note provides that it is secured by a general security interest over all of the assets of the Debtor, as provided in this Agreement.

NOW, THEREFORE, in consideration of the foregoing and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereby agree as follows:

1. Grant of Security Interest. The Debtor, in consideration of the funds advanced under the Notes, hereby grants, and conveys to the Collateral Agent, on behalf of the Secured Parties, a security interest in and to all of the Debtor's existing and future right, title and interest in, to and under the Collateral (as defined in Section 2). This security interest is granted to the Secured Parties to secure (a) the payment of all indebtedness evidenced by the Notes and all renewals, extensions, and modifications of the Notes; (b) the payment, performance and observance of all obligations, covenants and agreements to be paid, performed or observed by the Debtor to any of the Secured Parties; (c) the payment of all other sums, with interest thereon, advanced under the terms of this Agreement; and (d) the performance of the agreements and warranties of the Debtor contained in this Agreement, the Notes, the Purchase Agreement, or incorporated in any of these agreements by reference (the "**Obligations**"). The Secured Parties shall have all of the rights of a secured party under the Uniform Commercial Code of Delaware or any applicable jurisdiction where the Collateral may be located ("**UCC**"). The Secured Parties' security interest in the Collateral shall attach to all such Collateral without further action on the part of the Secured Parties.

2. Collateral. The property subject to the security interest (the "**Collateral**") includes all of the Debtor's tangible and intangible property and assets, wherever located and in whatever form, whether now owned or hereafter acquired, including, without limitation, the following:

2.1 All of the Debtor's machinery and equipment (as defined in the UCC), and all substitutions, creations, replacements and additions thereto and all components and auxiliary parts used in connection therewith, including all furniture and fixtures;

2.2 All of the Debtor's accounts, accounts receivable, contract rights, instruments, documents, chattel paper and general intangibles (as such terms are defined in the UCC);

2.3 All forms of obligations owing to the Debtor;

2.4 All tax refunds and tax refund claims;

2.5 All guaranties, security and liens for which the Debtor may hold for the payment or performance of any item of Collateral;

2.6 Letters of credit payable to the Debtor and all proceeds therefrom;

2.7 All rights to goods represented by any item of Collateral, or the sale of which goods gave rise to any item of Collateral;

2.8 the Debtor's good will;

2.9 All of the Debtor's inventory (as defined in the UCC), including all goods, merchandise, materials, raw materials, work in progress, finished goods, now owned or hereinafter acquired and held for sale or lease or furnished or to be furnished under contracts or service agreements or to be used or consumed in the Debtor's business and all other tangible personal property of the Debtor, wherever located, whether in the Debtor's or some other person's possession, and any materials and supplies of any kind used in connection with the Debtor's business or for packaging or shipping such inventory upon its return to replevy or repossession by the Debtor after sale;

2.10 All instruments of title or documents relating to any item of Collateral;

2.11 All the Debtor's books, records and lists in whatever form maintained related to any item of Collateral;

2.12 All patents and applications for a patent, including, without limitation, each patent and patent application referred to in Exhibit B attached hereto, together with all reissues, continuations, divisions, modifications, substitutions and extensions thereof;

2.13 All know-how, proprietary information, all software source and object code whether created or licensed by the Debtor, maskworks, all data that comprises the Debtor's databases;

2.14 All trademarks and copyrights;

2.15 All commercial tort claims;

2.16 Any other property which now or hereafter serves as security for the Obligations;

2.17 All property of the types described in Sections 2.1 through 2.15 or similar thereto, that at any time hereafter may be acquired by the Debtor, including but not limited to all accessions, parts, additions, and replacements; and

2.18 All proceeds of any item of Collateral and all proceeds of such proceeds, including (without limitation) all accounts, instruments, chattel paper or other rights to payment, money, insurance proceeds and all refunds of insurance premiums due or to become due under all insurance policies covering the foregoing property and proceeds derived from any condemnation of the Collateral.

3. Perfection of Security Interest. Concurrently with the execution of this Agreement, the Debtor shall deliver to Secured Parties, or their agents, a form or forms of National Financing Statement (Form UCC-1) and such other documentation as may be required or helpful as evidence of the granting and perfection of the security interest in the Collateral granted to the Secured Parties hereunder. The Secured Parties shall, immediately upon execution of this Agreement, cause the financing statement(s) to be filed with the Secretary of State of Delaware.

4. Subordination. Each Secured Party hereby agrees and acknowledges that the security interest granted to the Secured Parties pursuant to this Agreement is expressly subordinate to the Vault Loan (as such term is defined in the Purchase Agreement) and Permitted Indebtedness (see Section 2.1(a) of the Purchase Agreement. Additionally, the Secured Parties shall, from time to time, at the request of the Company, subordinate the portion security interest securing repayment of the Notes covering accounts receivable only to any accounts receivable or equipment based financing obtained by the Company from any bank or other lender.

5. Removal of Collateral Prohibited. The Debtor shall not permanently remove any Collateral from its premises without the written consent of the Collateral Agent, except that the Debtor may dispose of Collateral in the ordinary course of business.

6. Debtor's Representations, Warranties and Covenants. As long as the Debtor has outstanding Obligations to a Secured Party, the Debtor hereby represents, warrants and covenants with such Secured Party that:

6.1 The Debtor is a corporation duly organized and validly existing under the laws of the State of Delaware, and it will at all times take or cause to be taken all actions as may from time to time be necessary to maintain in good standing, preserve and renew its company existence and rights.

6.2 The Debtor and its officers signing this Agreement have the corporate power and authority to enter into and perform this Agreement and have taken all corporate action necessary to authorize the execution, delivery and performance of this Agreement and any related agreements or documents. This Agreement is a legal, valid and binding obligation of the Debtor, enforceable in accordance with its terms; and the Debtor's execution, delivery and performance of this Agreement does not conflict with or violate the Debtor's certificate of incorporation, bylaws, or any law, regulation, order, judgment, rule or agreement to which the Debtor is a party or by which it is bound.

6.3 Except for the Permitted Liens listed on Exhibit 6.3, all of the Collateral is and shall at all times remain free and clear of any and all liens, claims or encumbrances that are senior to the lien granted by this Agreement.

6.4 Except for inventory sold in the ordinary course of business, the Debtor has and will have good and indefeasible title to, and is and will be the true owner of the Collateral.

6.5 The execution of and performance by the Debtor of all of the terms and provisions contained in this Agreement do not and will not constitute, or would not constitute following any notice or lapse of time, an event of default under any agreement (including any existing loan agreement, promissory note or other loan document) to which the Debtor is now or hereafter becomes a party.

6.6 The Debtor will punctually pay or cause to be paid all payments of principal and interest to become due in respect of the Note according to the terms thereof.

6.7 The Debtor will keep, at all times, true and complete books of account and financial records in accordance with generally accepted accounting principles.

6.8 Within ten days after written notice from the Collateral Agent, the Debtor shall reimburse the Collateral Agent, for all sums expended by the Collateral Agent, in connection with the filing of any third-party claim as to the Collateral or any part thereof which the Collateral Agent may deem reasonably necessary or desirable, or in connection with any action brought by the Collateral Agent, to correct any default or enforce any provision of this Agreement, including reasonable attorneys' fees and expenses and court costs.

6.9 The Debtor will not sell, transfer or encumber the Collateral except in the ordinary course of business.

6.10 Except in the ordinary course of business, the Debtor shall not lease or otherwise dispose of, remove, move, relocate or transfer, or permit the removal, movement, relocation or transfer, whether by sale or otherwise, any of the Collateral, and shall keep the Collateral only at its principal place of business, or at any other secured warehouse or location owned or leased by the Debtor, or such other location as shall be used from time to time by the Debtor to temporarily store the Collateral so long as the Collateral remains fully insured, unless and until the Debtor provides Secured Party, with written notice that the Collateral is being moved to such location, specifying the exact address of such location and the exact Collateral to be moved, at least 30 days prior to moving the Collateral to such location.

7. **Protection of Secured Party's Security.** If an Event of Default, as defined in the Notes, has occurred, or if any action or proceeding is commenced which materially adversely affects the Collateral or title thereto or the interest of the Secured Parties therein, then the Secured Parties, upon the prior written consent of the Collateral Agent, may make such appearance, disburse such sums, and take such action as the Secured Parties deem necessary, in their sole discretion, to protect the Secured Parties' interest, including but not limited to (a) disbursement of reasonable hourly attorneys' fees, (b) entry upon the Debtor's property to make repairs to the Collateral, and (c) procurement of satisfactory insurance that is reasonable under the circumstances. Any amounts disbursed by the Secured Parties pursuant to this Section 7, with interest thereon, shall become additional indebtedness of the Debtor secured by this Agreement. Unless the Debtor and the Collateral Agent agree to other terms of payment, such amounts shall be immediately due and payable, and if the Secured Parties notify the Debtor within five days of such disbursement, all such amounts shall bear interest from the date which is ten days following the date of disbursement at the rate stated in the Notes. Nothing contained in this Section 7 shall require the Secured Parties to incur any expense or take any action.

8. Collateral Agent.

(a) Appointment. The Majority Noteholders may from time to time appoint a collateral agent for the Secured Parties (in such capacity, the “**Collateral Agent**”) to serve from the date of such appointment until the earliest of resignation, removal of the Collateral Agent by the Majority Noteholders, or termination of this Agreement. Upon ten days written notice to the Debtor, the Majority Noteholders (as such term is defined in the Purchase Agreement) may appoint another Collateral Agent.

(b) Powers and Duties of Collateral Agent. Each Secured Party hereby irrevocably authorizes the Collateral Agent, if any, to take such action and to exercise such powers hereunder as provided herein or as requested in writing by the Majority Noteholders. The Collateral Agent may execute any of its duties hereunder by or through agents or employees and shall be entitled to request and act in reliance upon the advice of counsel concerning all matters pertaining to its duties hereunder and shall not be liable for any action taken or omitted to be taken by it in good faith in accordance therewith. The Collateral Agent may not, without consent of the Majority Noteholders, demand payment of the Notes or foreclose on the Collateral. For the avoidance of doubt and without in any way limiting the rights of the Collateral Agent set forth herein, the Collateral Agent may with consent of the Majority Noteholders subordinate repayment of the Notes and their security interest hereby granted to other obligations of the Debtor.

(c) Indemnity by Secured Parties. Neither the Collateral Agent nor any of its partners, directors, officers, employees, or agents shall be liable or responsible to any Secured Party or to the Debtor for any action taken or omitted to be taken by the Collateral Agent or any other such person hereunder or under any related agreement, instrument or document, nor shall the Collateral Agent or any of its partners, directors, officers, employees, or agents be liable or responsible for: (i) the validity, effectiveness, sufficiency, enforceability or enforcement of the Notes, this Agreement or any instrument or document delivered hereunder or relating hereto; (ii) the title of the Debtor to any of the Collateral or the freedom of any of the Collateral from any prior or other liens or security interests; (iii) the determination, verification or enforcement of the Debtor’s compliance with any of the terms and conditions of this Agreement; (iv) the failure by the Debtor to deliver any instrument or document required to be delivered pursuant to the terms hereof; or (v) the receipt, disbursement, waiver, extension or other handling of payments or proceeds made or received with respect to the Collateral, the servicing of the Collateral or the enforcement or the collection of any amounts owing with respect to the Collateral. In the case of this Agreement, the transactions contemplated hereby and any document relating to the Collateral, each of the Secured Parties agrees to pay to the Collateral Agent, on demand, its pro rata share of all fees and all expenses incurred by the Collateral Agent in connection with the operation and enforcement of this Agreement, the Notes or any related agreement to the extent that such fees or expenses have not been paid by the Debtor. In the case of this Agreement and each instrument and document relating to any of the Collateral, each of the Secured Parties and the Debtor hereby agrees to hold the Collateral Agent harmless, and to indemnify the Collateral Agent from and against any and all loss, damage, expense or liability which may be incurred by the Collateral Agent under this Agreement and the transactions contemplated hereby and any related agreement or other instrument or document, as the case may be.

9. Forbearance by Collateral Agent Not a Waiver. Any forbearance by the Collateral Agent in exercising any right or remedy hereunder, or otherwise afforded by applicable law, shall not be a waiver of, or preclude the exercise of, any right or remedy. The acceptance by the Collateral Agent of payment of any sum secured by this Agreement or the Purchase Agreement after the due date of such payment shall not be a waiver of the Secured Parties’ right to either require prompt payment when due of all other sums so secured or to declare a default for failure to make prompt payment. No action taken by the Collateral Agent shall waive the Secured Parties’ right to accelerate the indebtedness secured by this Agreement and seek such other remedies as are provided by this Agreement, the Purchase Agreement or applicable law.

10. Uniform Commercial Code Security Agreement. This Agreement is intended to be a security agreement pursuant to the UCC for all of the items specified above as part of the Collateral which, under applicable law, may be subject to a security interest pursuant to the UCC, and the Debtor hereby grants the Collateral Agent a security interest in such items. The Debtor agrees that the Secured Parties may file any appropriate document in the appropriate jurisdiction as a financing statement for any of the Collateral. In addition, the Debtor agrees to execute, if necessary, and deliver to the Secured Parties, upon a Secured Party's request, any financing statements, as well as extensions, renewals and amendments thereof, and reproductions of this Agreement or the Purchase Agreement in such form as the Secured Parties may require to perfect a security interest with respect to said Collateral. The Debtor shall pay all costs of filing such financing statements and any extensions, renewals, amendments, and releases thereof, and shall pay all reasonable costs and expenses of any record searches for financing statements the Secured Parties may reasonably require. Without the prior written consent of the Collateral Agent, the Debtor shall not create or suffer to be created pursuant to the UCC any other security interest in the Collateral, including replacements and additions thereto, except under Section 4. Upon the occurrence of an Event of Default (as such term is defined in the Notes), the Secured Parties shall have the remedies of a "secured party" under the UCC and, at the Collateral Agent's option, may also invoke the other remedies provided in this Agreement, the Notes, or the Purchase Agreement as to such items. In exercising any of such remedies, the Secured Parties may proceed against any or all of the Collateral separately or together and in any order whatsoever, without in any way affecting the availability of the Secured Parties remedies under the UCC or of the other remedies provided in this Agreement and/or the Subscription Agreement.

11. Events of Default. The Debtor shall be in default under this Agreement upon the occurrence of an Event of Default (as such term is defined in the Notes) or a breach of the Purchase Agreement.

12. Rights of Secured Parties.

(a) Upon the occurrence of an Event of Default (as such term is defined in the Notes) or a breach of the Purchase Agreement, the Collateral Agent may, at the request of the Majority Noteholders, require the Debtor to assemble the Collateral and make it available to the Collateral Agent at the place to be designated by the Collateral Agent which is reasonably convenient to both parties. The Collateral Agent may sell all or any part of the Collateral as a whole or in parcels either by public auction, private sale, or other method of disposition pursuant to the UCC. The Collateral Agent or any Secured Party may bid at any public sale on all or any portion of the Collateral. The Collateral Agent shall give the Debtor reasonable notice of the time and place of any public sale or of the time after which any private sale or other disposition of the Collateral is to be made, and notice given at least ten days before the time of the sale or other disposition shall be conclusively presumed to be reasonable.

(b) Notwithstanding any provision of this Agreement, the Collateral Agent shall be under no obligation to offer to sell the Collateral. In the event the Collateral Agent offers to sell the Collateral, the Collateral Agent will be under no obligation to consummate a sale of the Collateral if, in its reasonable business judgment, none of the offers received by it reasonably approximates the fair value of the Collateral.

(c) In the event the Collateral Agent elects not to sell the Collateral, the Collateral Agent may elect to follow the procedures set forth in the UCC for retaining the Collateral in satisfaction of the Debtor's obligation, subject to the Debtor's rights under such procedures.

13. Remedies Cumulative. Each remedy provided in this Agreement or the Purchase Agreement is distinct and cumulative to all other rights or remedies under this Agreement or the Purchase Agreement or afforded by law or equity, and may be exercised concurrently, independently, or successively, in any order whatsoever.

14. Costs and Expenses. The Debtor agrees to pay on demand all costs and expenses, including reasonable hourly attorneys fees and court costs, of the Secured Parties in connection with the enforcement of this Agreement (whether suit is commenced or not).

15. Notices, etc. All notices, requests, demands, approvals, consents, and other communications which are required or may be given hereunder shall be (a) in writing; (b) addressed to the address furnished addressed to the parties as set forth on the signature page hereto, unless a party notifies the others of a change of address (in which case the latest noticed address shall be used); and (c) deemed to have been duly given (i) on the date given by hand delivery or facsimile, or (ii) the day after deposit with a recognized overnight courier; provided that if the actual or deemed notice date is not a business day, the date of actual or deemed notice shall be the next business day thereafter.

16. Entire Agreement, Savings Clause, Assigns and Governing Law. This Agreement, the Purchase Agreement, the Notes and all documents referenced therein contain the entire understanding between and among the parties and supersede any prior understandings and agreements among them respecting the subject matter of such agreements and instruments. If any provision of this Agreement, or the application of such provision to any person or circumstance, shall be held invalid, the remainder of this Agreement, or the application of such provision to persons or circumstances other than those as to which it is held invalid, shall not be affected thereby. This Agreement shall be binding upon the heirs, executors, administrators, successors and assigns of the parties hereto. This Agreement shall be governed by and construed in accordance with the laws of the State of Minnesota.

17. Amendment and Additional Parties. The Agreement may be amended only in writing signed by the Debtor and the Collateral Agent.

18. Attorneys' Fees. Any actions or proceedings, including arbitration, brought by either party with respect to this Agreement, the court or arbitrator in such action or proceeding shall award to the prevailing party, in addition to any other relief granted, (i) the actual attorneys' fees based on a reasonable hourly basis which the prevailing party has paid or is obligated to pay; and (ii) all costs and expenses, not merely recoverable costs, which the prevailing party has paid or is obligated to pay. The court may reduce such actual attorneys' fees, costs and expenses only to the extent that the court determines that such amounts were unnecessarily incurred or unreasonable. In addition, the parties agree that if any dispute between the parties results in a judgment in favor of either party, such party shall be entitled to recover from the other all reasonable hourly attorneys' fees and costs incurred by it in enforcing such judgment. This provision is intended to be severable from any other provision of this Agreement and is not to be deemed merged in the judgment.

[E/O]

CRC: 9395  
EDGAR 2

**BPC C17782 710.03.08.00 0/1**  


---

19. Time is of the Essence. TIME IS EXPRESSLY DECLARED TO BE OF THE ESSENCE of each Obligation of the Debtor hereunder and in all matters concerning this Agreement, including all acts or things to be done or performed in connection herewith, and specifically of every provision of this Agreement and the Notes in which time is an element.

20. Counterparts; Execution. This Agreement may be executed in multiple counterparts, each of which shall be deemed an original Agreement, and all of which shall constitute one Agreement to be effective as of the date of execution of this Agreement.

[Multiple signature pages follow.]

[E/O]

CRC: 16447  
EDGAR 2

**BPC C17782 710.03.09.00 0/1**  


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

**THE DEBTOR:**

**COLLATERAL AGENT:**

**DIGITILITI, Inc.**  
a Delaware corporation

**INSERT NAME OF COLLATERAL AGENT, IF ANY**

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Its: \_\_\_\_\_

By: \_\_\_\_\_  
Name: \_\_\_\_\_  
Its: \_\_\_\_\_

Address: 266 East 7th Street, St. Paul, MN 55101  
Phone:  
Fax:

Address:  
Phone:  
Fax:

[Multiple secured party signature pages follow.]

---

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

**SECURED PARTY:**

Name: \_\_\_\_\_

Sign: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

(Address)

\_\_\_\_\_

(Phone and Fax Numbers)

**[E/O]**

CRC: 40692  
**EDGAR 2**

**BPC C17782 710.03.11.00 0/1**  


---

**SCHEDULE A**  
**SECURED PARTIES**

**[E/O]**

CRC: 58213  
**EDGAR 2**

**BPC C17782 710.03.12.00 0/1**  


---

**EXHIBIT B**

**LIST OF PATENTS AND PATENT APPLICATIONS**

---

**EXHIBIT 6.3**

**PERMITTED LIENS**

**“Permitted Liens” are:**

- (a) Liens approved in writing by the Collateral Agent or the Majority Noteholders;
- (b) Liens for taxes, fees, assessments or other government charges or levies, either not delinquent or being contested in good faith and for which the Debtor maintains adequate reserves on its books;
- (c) Purchase money liens (i) on equipment acquired or held by the Debtor incurred for financing the acquisition of the equipment, or (ii) existing on equipment when acquired, if the lien is confined to the property and improvements and the proceeds of the equipment;
- (d) Leases or subleases and licenses or sublicenses granted in the ordinary course of the Debtor’s business including those listed on Attachment A incorporated herein by reference; and
- (e) Liens of carriers, warehousemen, suppliers, or other persons that are possessory in nature arising in the ordinary course of business so long as such liens attach only to inventory and which are not delinquent or remain payable without penalty or which are being contested in good faith and by appropriate proceedings which proceedings have the effect of preventing the forfeiture or sale of the property subject thereto.



<DOCUMENT>  
<TYPE> EX-10.4  
<FILENAME> c17782exv10w4.htm  
<DESCRIPTION> EX-10.4  
<TEXT>

EXHIBIT 10.4

THIS SECURITY HAS NOT BEEN REGISTERED UNDER EITHER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR APPLICABLE BLUE SKY LAWS, AND IS SUBJECT TO CERTAIN INVESTMENT REPRESENTATIONS. THIS SECURITY MAY NOT BE SOLD, OFFERED FOR SALE OR TRANSFERRED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION UNDER THE ACT AND APPLICABLE BLUE SKY LAWS, OR AN OPINION OF COUNSEL SATISFACTORY TO THE COMPANY THAT SUCH REGISTRATION IS NOT REQUIRED.

Warrant No. \_\_\_\_\_

WARRANT TO PURCHASE CAPITAL STOCK  
of  
DIGITILITI, INC.  
a Delaware corporation

Void after January \_\_, 2016

This certifies that, for value received, [\_\_\_\_\_], or his, her or its successors or assigns ("**Holder**"), is entitled during the Exercise Period (as defined below), subject to the terms set forth below, to purchase from Digitiliti, Inc., a Delaware corporation (the "**Company**"), up to [\_\_\_\_\_] shares of Common Stock, par value \$.001 per share, of the Company ("**Common Stock**") at the price of \$0.30 per share, subject to adjustment as set forth below (the "**Purchase Price**"), upon surrender of this Warrant at the principal office of the Company referred to below, with the subscription form attached hereto (the "**Subscription Form**") duly executed, and simultaneous payment therefor in the manner specified in Section 1 or in accordance with Section 5. The Purchase Price and the number of shares of capital stock purchasable hereunder are subject to adjustment as provided in Section 3. This Warrant is one of the warrants (collectively, the "**Warrants**") referred to and issued pursuant to that certain Convertible Promissory Note and Warrant Purchase Agreement dated as of January \_\_\_\_, 2011 (the "**Purchase Agreement**").

As used herein, "**Exercise Date**" means the particular date (or dates) on which this Warrant is exercised. "**Exercise Period**" means the period during which this Warrant is exercisable; such period shall begin on the date hereof and shall end at 6:00 p.m., Central Daylight Time, on January \_\_\_\_, 2016. "**Issue Date**" means the date hereof, January \_\_\_\_, 2011. "**Warrant**" includes this Warrant and any warrant delivered in substitution or exchange therefor as provided herein. "**Warrant Shares**" means any shares of capital stock acquired by Holder upon exercise of this Warrant.

**1. Exercise.**

(a) This Warrant may be exercised, in whole or in part, at any time or from time to time, on any business day during the Exercise Period, for all or any part of the number of shares of capital stock called for hereby, by surrendering it at the principal office of the Company at 266 East 7th Street, Saint Paul, MN 55101, together with an executed Subscription Form which is completed in accordance with Section 5, or which is accompanied by a check in an amount equal to (i) the number of Warrant Shares being purchased, multiplied by (ii) the Purchase Price.

(b) This Warrant may be exercised for less than the full number of Warrant Shares as of the Exercise Date. Upon such partial exercise, this Warrant shall be surrendered, and a new Warrant of the same tenor and for the purchase of the Warrant Shares not purchased upon such exercise shall be issued to Holder by the Company.

(c) A Warrant shall be deemed to have been exercised immediately prior to the close of business on the date of its surrender for exercise as provided above, and the person entitled to receive the Warrant Shares issuable upon such exercise shall be treated for all purposes as the holder of such shares of record as of the close of business on such date. As soon as practicable on or after such date, and in any event within five business days thereafter, the Company shall issue and deliver to the person or persons entitled to receive the same a certificate or certificates for the number of full shares of capital stock issuable upon such exercise, together with cash, in lieu of any fraction of a share, equal to such fraction of the current fair market value of one full share as reasonably determined in good faith by the Company's Board of Directors (the "**Board**").

**2. Payment of Taxes.** All shares of capital stock issued upon the exercise of this Warrant shall be validly issued, fully paid and non-assessable and the Company shall pay all taxes and other governmental charges that may be imposed in respect of the issue or delivery thereof, other than any tax or other charge imposed in connection with any transfer involved in the issue of any certificate for shares of capital stock in any name other than that of the registered Holder of this Warrant surrendered in connection with the purchase of such shares, and in such case the Company shall not be required to issue or deliver any stock certificate until such tax or other charge has been paid or it has been established to the Company's satisfaction that no tax or other charge is due.

**3. Certain Adjustments.**

(a) Adjustment for Reorganization, Consolidation, Merger. In case of any reclassification or change of outstanding Company securities, or of any reorganization of the Company (or any other entity, the stock or securities of which are at the time receivable upon the exercise of this Warrant) or any similar corporate reorganization on or after the date hereof, then and in each such case Holder, upon the exercise hereof at any time after the consummation of such reclassification, change, reorganization, merger or conveyance, shall be entitled to receive, in lieu of the stock or other securities and property receivable upon the exercise hereof prior to such consummation, the stock or other securities or property to which Holder would have been entitled upon such consummation if Holder had exercised this Warrant immediately prior thereto, the terms of this Section 3 shall be applicable to the Company securities properly receivable upon the exercise of this Warrant after such consummation.

(b) Adjustments for Dividends in Common Stock. In case at any time after the Issue Date the Company shall declare any dividend on the Common Stock (or any other securities that are at the time receivable upon the exercise of this Warrant) which is payable in shares of Common Stock (or any other securities that are at the time receivable upon the exercise of this Warrant), the number of Warrant Shares issuable upon exercise of this Warrant shall be proportionately increased and the Purchase Price shall be proportionately decreased.

(c) Stock Split and Reverse Stock Split. If the Company at any time or from time to time after the Issue Date effects a subdivision of the Common Stock (or any other securities that are at the time receivable upon exercise of this Warrant), the Purchase Price shall be proportionately decreased and the number of Warrant Shares issuable upon exercise of this Warrant shall be proportionately increased. If the Company at any time or from time to time after the Issue Date combines the outstanding shares of Common Stock (or any other securities that are at the time receivable upon exercise of this Warrant) into a smaller number of shares, the Purchase Price shall be proportionately increased and the number of Warrant Shares issuable upon exercise of this Warrant shall be proportionately decreased. Each adjustment under this Section 3(c) shall become effective at the close of business on the date the subdivision or combination becomes effective.

(d) Accountants' Certificate as to Adjustment. In each case of an adjustment in the shares of capital stock receivable on the exercise of this Warrant, if Holder so requests in writing, the Company at its expense shall cause independent public accountants of recognized standing selected by the Company (who may be the independent public accountants then auditing the books of the Company) to compute such adjustment in accordance with the terms of this Warrant and prepare a certificate setting forth such adjustment and showing the facts upon which such adjustment is based. The Company will promptly thereafter mail a copy of each such certificate to each holder of a Warrant at the time outstanding.

(e) Rights Under Warrant Agreement. The Company will not, by amendment of its Certificate of Incorporation, as amended, or through reorganization, consolidation, merger, dissolution, issue or sale of securities, sale of assets or any other voluntary action, avoid or seek to avoid the observance or performance of any of the terms of this Warrant, but will at all times in good faith assist in the carrying out of all such terms and in the taking of all such action as may be necessary or appropriate in order to protect the rights of the holders of the Warrants under this Warrant Agreement.

**4. Notices of Record Date.** If either (a) the Company shall take a record of the holders of its Common Stock (or other stock or securities at the time receivable upon the exercise of the Warrants) for the purpose of entitling them to receive any dividend or other distribution, or any right to subscribe for or purchase any shares of stock of any class or any other securities, or to receive any other right; or (b) the Company undertakes a voluntary dissolution, liquidation or winding-up of the Company, then, and in each such case, the Company shall mail or cause to be mailed to each holder of a Warrant at the time outstanding a notice specifying, as the case may be, (1) the date on which a record is to be taken for the purpose of such dividend, distribution or right, and stating the amount and character of such dividend, distribution or right, or (2) the date on which such reorganization, reclassification, consolidation, merger, conveyance, dissolution, liquidation or winding-up is to take place, and the time, if any is to be fixed, as of which the holders of record of Common Stock (or such stock or securities at the time receivable upon the exercise of the Warrants) shall be entitled to exchange their shares of Common Stock (or such other stock or securities) for securities or other property deliverable upon such reorganization, reclassification, consolidation, merger, conveyance, dissolution, liquidation or winding-up. Such notice shall be mailed at 30 days prior to the date therein specified.

**5. Cashless Exercise.**

(a) Holder may, at its option, in lieu of paying the Purchase Price upon exercise of this Warrant pursuant to Section 1, elect to instead receive a number of Warrant Shares computed using the following formula:

$$X = \frac{Y(A-B)}{A}$$

where: X = the number of Warrant Shares issuable to Holder upon exercise under this Section 5; Y = the number of Warrant Shares requested by Holder on the Subscription Form; A = the Fair Market Value (as defined below) of one share of Common Stock (or such stock or securities at the time receivable upon exercise of this Warrant) as of the exercise date; and B = the Purchase Price.

(b) As used in this Section 5, “**Fair Market Value**” of a share of capital stock on any particular date shall mean:

(i) if the exercise is in connection with a liquidation, dissolution or winding up (as defined in the Certificate of Incorporation), the fair market value of the Warrant Shares shall be deemed to be the value received by the holders of such stock pursuant to such liquidation, dissolution or winding up; or

(ii) if the exercise is not in connection with a liquidation, dissolution or winding up, and the capital stock is traded publicly on an exchange or national quotation system, the average of the closing bid and asked prices of the Company’s capital stock quoted in the over-the-counter market summary or the closing price quoted on any exchange on which the common stock is listed, whichever is applicable, as published in the Midwest Edition of the Wall Street Journal (or other reliable source if such quote is not available in the Wall Street Journal) for the ten trading days immediately prior to but not including the date of determination of the Fair Market Value; or

(iii) if (i) or (ii) is not applicable, the fair market value of the Warrant Shares thereof, as mutually determined by the Company and Holder or, if the Company and Holder are unable to reach such agreement, as determined by a nationally recognized independent investment banker or valuation consultant (which has not been retained by the Company or any of its affiliates for the two years preceding such determination) selected in good faith by the Board.

**6. Put Right.** In connection with a bona fide business acquisition of the Company, whether by merger, consolidation, sale of assets, sale or exchange of shares or otherwise (an “**Acquisition**”), upon the written request of Holder, the Company (or its successor entity) shall purchase this Warrant from Holder contemporaneously with the closing of the Acquisition by paying to Holder cash in an amount equal to the Black Scholes Value obtained from the “OV” function on the Bloomberg Financial Markets of the remaining unexercised portion of this Warrant on the date immediately prior to the date on which the Acquisition is consummated. The Company will provide Holder notice of a pending Acquisition not less than 20 nor more than 60 days prior to the closing thereof; provided, however, nothing herein shall obligate the Company to provide Holder with material, non-public information.

**7. No Rights as Shareholder.** Prior to the exercise of this Warrant, Holder shall not be entitled to any rights of a shareholder with respect to the Warrant Shares, including without limitation the right to vote such Warrant Shares, receive dividends or other distributions thereon or be notified of shareholder meetings, and Holder shall not be entitled to any notice or other communication concerning the business or affairs of the Company. However, nothing in this Section 7 shall limit the right of Holder to be provided the notices required under this Warrant. In addition, nothing contained in this Warrant shall be construed as imposing any liabilities on Holder to purchase any securities (upon exercise of this Warrant or otherwise) or as a shareholder of the Company, whether such liabilities are asserted by the Company or by creditors of the Company.

**8. Compliance with Securities Act.** Holder, by acceptance hereof, agrees that this Warrant and the Warrant Shares to be issued upon exercise hereof are being acquired for investment and not with a view towards resale and that it will not offer, sell or otherwise dispose of this Warrant or any Warrant Shares to be issued upon exercise hereof except under circumstances which will not result in a violation of the Act. Upon exercise of this Warrant, Holder shall confirm in writing, in the form of Exhibit A, that the Warrant Shares so purchased are being acquired for investment and not with a view toward distribution or resale. This Warrant and all shares of Warrant Shares issued upon exercise of this Warrant (unless registered under the Act) shall be stamped or imprinted with the legend indicated on the first page of this Warrant.

**9. Loss or Mutilation.** Upon receipt by the Company of evidence satisfactory to it (in the exercise of reasonable discretion) of the ownership of and the loss, theft, destruction or mutilation of any Warrant and (in the case of loss, theft or destruction) of indemnity satisfactory to it (in the exercise of reasonable discretion), and (in the case of mutilation) upon surrender and cancellation thereof, the Company will execute and deliver in lieu thereof a new Warrant of like tenor.

**10. Notices.** All notices, requests, demands, approvals, consents, and other communications which are required or may be given hereunder shall be (a) in writing; (b) addressed to the address furnished to the Company by Holder, unless Holder notifies the Company of a change of address (in which case the latest noticed address shall be used); and (c) deemed to have been duly given (i) on the date given by hand delivery or facsimile, or (ii) the day after deposit with a recognized overnight courier; provided that if the actual or deemed notice date is not a business day, the date of actual or deemed notice shall be the next business day thereafter.

**11. Change; Waiver.** Neither this Warrant nor any term hereof may be changed, waived, discharged or terminated orally, but only by an instrument in writing signed by the Company and the Majority Noteholders (as defined in the Purchase Agreement).

**12. Headings.** The headings in this Warrant are for purposes of convenience in reference only, and shall not be deemed to constitute a part hereof.

**13. Governing Law.** This Warrant is delivered in Minnesota and shall be construed and enforced in accordance with and governed by the internal laws, and not the law of conflicts thereof.

[E/O]

CRC: 30141  
EDGAR 2

**BPC C17782 710.04.06.00 0/1**  


---

**IN WITNESS WHEREOF**, the Company has caused its duly authorized officer to execute this Warrant as of the date first above written.

**COMPANY:**

DIGITILITI, INC.

By: \_\_\_\_\_

Name: \_\_\_\_\_

Its: \_\_\_\_\_

[Signature Page to Warrant]

**EXHIBIT A**

**SUBSCRIPTION FORM**

(To be executed only upon exercise of Warrant)

The undersigned registered owner of this Warrant irrevocably exercises this Warrant and purchases \_\_\_\_\_ of the number of shares of Common Stock of DIGITILITI, INC., a Delaware corporation, purchasable with this Warrant, and herewith (*check one of the following*)

- (a) \_\_\_\_\_ makes payment therefore in the amount of \$ \_\_\_\_\_; or
- (b) \_\_\_\_\_ authorizes Digitiliti, Inc. to issue the shares in accordance with the Cashless Exercise Provisions of Section 5 of the Warrant.

The undersigned hereby represents and warrants that the undersigned is acquiring such shares for its own account for investment purposes only, and not for resale or with a view to distribution of such shares or any part thereof.

Dated: \_\_\_\_\_

\_\_\_\_\_  
(Signature of Registered Owner)

\_\_\_\_\_  
(Street Address)

\_\_\_\_\_  
(City), (State), (Zip)

[E/O]

CRC: 10864  
EDGAR 2

**BPC C17782 710.04.08.00 0/1**  


**FORM OF ASSIGNMENT**

FOR VALUE RECEIVED the undersigned registered owner of this Warrant hereby sells, assigns and transfers unto the Assignee named below all of the rights of the undersigned under the within Warrant, with respect to the number of shares of Common Stock set forth below:

Name of Assignee \_\_\_\_\_ Address \_\_\_\_\_ No. of Shares \_\_\_\_\_

and does hereby irrevocably constitute and appoint \_\_\_\_\_ Attorney to make such transfer on the books of DIGITILITI, INC., a Delaware corporation, maintained for the purpose, with full power of substitution in the premises.

Dated: \_\_\_\_\_

\_\_\_\_\_  
(Signature)

\_\_\_\_\_  
(Print Name)

\_\_\_\_\_  
(Witness)

\_\_\_\_\_  
(Print Name)



<DOCUMENT>  
<TYPE> EX-10.5  
<FILENAME> c17782exv10w5.htm  
<DESCRIPTION> EX-10.5  
<TEXT>

**REPAYMENT OF NOTE OBLIGATIONS  
AND RELEASE OF SECURITY INTEREST**

**THIS REPAYMENT AND RELEASE AGREEMENT** (the “Agreement”) is made and entered into effective the latest signature date set forth below by and among Jonathan S. Miner and Pamela J. Miner (collectively, the “Holders”), Digitiliti, Inc., a Delaware corporation (“Digitiliti Delaware”), and Digitiliti, Inc., a Minnesota corporation (“Digitiliti Minnesota”).

**WHEREAS**, in 2005 Digitiliti Minnesota issued to Holder Jonathan S. Miner a Promissory Note in the original principal amount of \$250,000 (the “Digitiliti North Star Note”), the purpose of which was to reimburse and pay to said Jonathan S. Miner certain sums he had borrowed from North Star Bank and subsequently advanced to Digitiliti Minnesota; and

**WHEREAS**, on or about 2005 Holder Pamela J. Miner lent to Digitiliti Minnesota the sum of \$50,000, which loan has not been memorialized or reduced to a note or similar instrument (the “Pamela J. Miner Loan”); and

**WHEREAS**, Digitiliti Delaware issued to Holders a 12% Convertible Secured Note dated November 20, 2008 in the original principal amount of \$250,000 (the “Convertible Note”); and

**WHEREAS**, pursuant to a Security Agreement effective December 3, 2008 (the “Security Agreement”) between Digitiliti Delaware and Digitiliti Minnesota (collectively, “Digitiliti”), as debtors, and Holders, as secured parties, Holders were granted a security interest in various collateral as defined in the Security Agreement (the “Collateral”) relating to Digitiliti’s business as security for repayment of the Digitiliti North Star Note and the Convertible Note; and

**WHEREAS**, a UCC Financing Statement (the “UCC Financing Statement”) was filed with the State of Minnesota on December 18, 2008 as file number 200814262422 in connection with Holders’ security interest in the Collateral; and

**WHEREAS**, the Digitiliti North Star Note, the Pamela J. Miner Note and the Convertible Note (collectively, the “Miner Notes”) have all matured and are due and payable in full at this time; and

**WHEREAS**, as of February 28, 2011, the total aggregate principal due on the Miner Notes is \$531,540.00, and the total aggregate accrued and unpaid interest through said date is \$\_\_\_\_\_; and

**WHEREAS**, the parties desire to take the actions described below in order to repay the Miner Notes in full and to terminate and release the Holders’ security interests in the Collateral resulting from the Security Agreement and the UCC Financing Statement.

**NOW, THEREFORE**, for good and valuable consideration, including the recitals set forth above, the receipt and sufficiency of which are herewith acknowledged, the parties agree as follows:

1. Repayment of the Miner Notes. The Holders and Digitiliti agree that the Miner Notes shall be repaid in full as to all amounts owed by Digitiliti under the Miner Notes, and the Miner Notes shall thereafter be cancelled, upon completion of the following:
  - a. Digitiliti shall immediately pay to Holders the sum of \$184,413.65 by wire transfer.
  - b. Digitiliti shall immediately pay to North Star Bank the sum of \$247,126.35 in full satisfaction and settlement of the existing note between Holders and North Star Bank in the original principal sum of \$250,000. Digitiliti shall provide Holders with written evidence that such note has been satisfied and paid in full and shall hold the Holders harmless from any claims based upon the same.
  - c. The sum of \$100,000, representing a portion of the principal balance due under the Miner Notes, shall be rolled into a secured promissory note from Digitiliti Delaware, as lender, to Holders, as holders and secured parties, as part of an existing secured convertible debt offering of Digitiliti Delaware. The secured promissory note shall be in the original principal amount of \$110,000. The Holders' participation in such offering shall be consistent with and no less favorable than the notes, security interests, warrants and other agreements given to the other participants in said offering.
  - d. Digitiliti Delaware shall issue and deliver to Holders, in whatever denominations and names as Holders may indicate in writing, certain shares of common stock of Digitiliti Delaware, which shall be fully paid and non-assessable upon issuance. Said shares shall represent payment for accrued interest under the Miner Notes at the rate of \$0.15 per share. The shares issued with respect to such accrued interest shall not include a "restricted legend" to the extent the underlying note or notes contain applicable conversion terms. To the extent any underlying note does not contain conversion terms, the shares issued in connection with such note may have to be held by Holders for six months (as a non-affiliate) before said Holders can register the shares as free trading shares.
  - e. Digitiliti Delaware shall issue to Holders a warrant (the "Signing Warrant") to purchase up to 200,000 shares of Digitiliti Delaware's common stock. The Signing Warrant shall have a five year term, \$0.20 per share exercise price and include a cashless exercise provision and a put right in the event of an acquisition of Digitiliti Delaware valued at the Black Scholes Value of the unexercised portion of the Warrant obtained from the "OV" function on Bloomberg determined as of the day prior to the announcement of the transaction. The Signing Warrant shall include antidilution provisions for stock splits, stock dividends and recapitalizations. The Signing Warrant is given in connection with certain claims made by Holders that they should have been paid options or warrants to purchase shares of common stock of Digitiliti Delaware in connection with previous guaranties and loans, in addition to the Miner Notes, made by Holders on behalf of Digitiliti Delaware.

- f. Holders are the holders of (i) an existing warrant to purchase 100,000 shares of common stock of Digitiliti Delaware at \$0.50 per share exercisable over a five year term commencing October 16, 2008 and (ii) an existing warrant to purchase 250,000 shares of common stock of Digitiliti Delaware at \$0.35 per share exercisable over a five year term commencing November 20, 2008 (collective, the "Existing Warrants"). The Existing Warrants shall be modified to reduce the exercise or strike price to \$0.15 per share and to extend the term thereof to provide for exercise up to five years commencing as of the date hereof.
- 2. Termination and Release of Security Interest. Upon completion of the conditions set forth in section 1 above, the Holders agree to terminate and release any security interests, rights, titles and interests they may have under the Security Agreement and the UCC-1 Financing Statement by signing the attached "Termination and Release of Security Interest," which is attached as Exhibit A hereto.
- 3. Execution. This Agreement may be executed in one or more separate counterparts, each of which when signed shall for all purposes be deemed to be an original and all of which when taken together shall constitute a valid and binding agreement. For purposes of this Agreement, facsimile or electronically transmitted signatures shall be deemed acceptable to and binding upon the parties and shall constitute delivery.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement effective as the latest signature date set forth below.

**HOLDERS:**

Dated: \_\_\_\_\_, 2011

\_\_\_\_\_  
Jonathan S. Miner

Dated: \_\_\_\_\_, 2011

\_\_\_\_\_  
Pamela J. Miner

**DIGITILITI, INC., a Delaware corporation**

Dated: \_\_\_\_\_, 2011

\_\_\_\_\_  
By: Ehssan Taghizadeh  
Its: Chief Executive Officer

**DIGITILITI, INC., a Minnesota corporation**

Dated: \_\_\_\_\_, 2011

\_\_\_\_\_  
By: Ehssan Taghizadeh  
Its: Chief Executive Officer



<DOCUMENT>  
<TYPE> EX-31.1  
<FILENAME> c17782exv31w1.htm  
<DESCRIPTION> EX-31.1  
<TEXT>

**Exhibit 31.1**

**CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Ehssan Taghizadeh, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Digitiliti, 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(s) 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 15d-15(f)) for the Registrant and 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 Quarterly 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 Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Quarterly Report based on such evaluation; and
  - d) disclosed in this Quarterly 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(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions);
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control 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 control over financial reporting.

Date: May 23, 2011

By: /s/ Ehssan Taghizadeh  
Ehssan Taghizadeh, CEO, President and Director



<DOCUMENT>  
<TYPE> EX-31.2  
<FILENAME> c17782exv31w2.htm  
<DESCRIPTION> EX-31.2  
<TEXT>

**Exhibit 31.2**

**CERTIFICATION PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I William McDonald, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Digitiliti, 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(s) 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 15d-15(f)) for the Registrant and 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 Quarterly 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 Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this Quarterly Report based on such evaluation; and
  - d) disclosed in this Quarterly 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(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of the Registrant's board of directors (or persons performing the equivalent functions);
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control 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 control over financial reporting.

Date: May 23, 2011

By: /s/ William McDonald  
William McDonald, CFO



<DOCUMENT>  
<TYPE> EX-32.1  
<FILENAME> c17782exv32w1.htm  
<DESCRIPTION> EX-32.1  
<TEXT>

**Exhibit 32.1**

**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 Digitiliti, Inc. (the "Registrant") on Form 10-Q for the period ending September 30, 2009, as filed with the Securities and Exchange Commission on the date hereof (the "Quarterly Report"), we, Roy A. Bauer, President and CEO, and William McDonald, CFO of the Registrant, 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 our knowledge:

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

(2) The information contained in the Quarterly Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

Date: May 23, 2011

By: /s/ Ehssan Taghizadeh  
Ehssan Taghizadeh, CEO and President

Date: May 23, 2011

By: /s/ William McDonald  
William McDonald, CFO

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