

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 December 31, 2005

or

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

Commission File Number: 0-26824

**TEGAL CORPORATION**

*(Exact Name of Registrant as Specified in Its Charter)*

Delaware  
*(State or other jurisdiction of  
incorporation or organization)*

68-0370244  
*(I.R.S. Employer Identification No.)*

2201 South McDowell Blvd.  
Petaluma, California 94954  
*(Address of Principal Executive Offices)*

Telephone Number (707) 763-5600  
*(Registrant's Telephone Number, Including Area Code)*

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 reports) and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

As of February 9, 2006 there were 83,973,854 shares of our common stock outstanding.

**TEGAL CORPORATION AND SUBSIDIARIES**

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**PART I — FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements**

**TEGAL CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(Unaudited)  
(In thousands, except share data)

	December 31, <u>2005</u>	March 31, <u>2005</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 15,111	\$ 7,093
Accounts receivable, net of allowances for sales returns and doubtful accounts of \$219 and \$533 at December 31, and March 31, 2005 respectively	6,031	1,897
Inventories	7,370	5,140
Prepaid expenses and other current assets	2,626	641
	<u>          </u>	<u>          </u>
Total current assets	31,138	14,771
Property and equipment, net	1,994	3,342
Intangible assets, net	1,553	1,796
Other assets	189	183
	<u>          </u>	<u>          </u>
Total assets	\$ 34,874	\$ 20,092
	<u>          </u>	<u>          </u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Notes payable and bank lines of credit	\$ 31	\$ 159
Accounts payable	3,474	3,607
Accrued product warranty	425	252
Deferred revenue	827	122
Accrued expenses and other current liabilities	2,357	2,575
	<u>          </u>	<u>          </u>
Total current liabilities	7,114	6,715
Long-term portion of capital lease obligations	5	13
Other long term obligations	25	64
	<u>          </u>	<u>          </u>
Total long term liabilities	30	77
	<u>          </u>	<u>          </u>
Total liabilities	7,144	6,792
	<u>          </u>	<u>          </u>
Stockholders' equity:		
Preferred stock; \$0.01 par value; 5,000,000 shares authorized; none issued and outstanding	—	—
Common stock; \$0.01 par value; 200,000,000 shares authorized; 83,973,854 and 52,843,520 shares issued and outstanding at December 31, 2005 and March 31, 2005 respectively	840	528
Restricted Share Units	1,280	—
Deferred Compensation	(276)	—
Additional paid-in capital	118,741	99,156
Accumulated other comprehensive income (loss)	512	(110)
Accumulated deficit	(93,367)	(86,274)
	<u>          </u>	<u>          </u>
Total stockholders' equity	27,730	13,300
	<u>          </u>	<u>          </u>
Total liabilities and stockholders' equity	\$ 34,874	\$ 20,092
	<u>          </u>	<u>          </u>

See accompanying notes.

**TEGAL CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)

(In thousands, except per share data)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2005	2004	2005	2004
Revenue	\$ 6,246	\$ 2,903	\$ 15,704	\$ 11,332
Cost of sales	4,565	2,377	10,905	8,105
Gross profit (loss)	1,681	526	4,799	3,227
Operating expenses:				
Research and development	1,039	1,578	3,426	4,243
Sales and marketing	694	704	2,095	2,230
General and administrative	1,128	1,178	5,766	4,771
In-process research and development	—	—	—	1,653
Total operating expenses	2,861	3,460	11,287	12,897
Operating loss	(1,180)	(2,934)	(6,488)	(9,670)
Other income (expense), net				
Interest income (expense), net	142	(2)	166	(2,065)
Other income (expense)	(866)	248	(770)	221
Total other income (expense), net	(724)	246	(604)	(1,844)
Net loss	\$ (1,904)	\$ (2,688)	\$ (7,092)	\$ (11,514)
Net loss per share, basic and diluted	\$ (0.02)	\$ (0.06)	\$ (0.11)	\$ (0.26)
Shares used in per share computation:				
Basic	83,945	47,733	63,137	45,135
Diluted	83,945	47,733	63,137	45,135

See accompanying notes.

**TEGAL CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**  
**(In thousands)**

	Nine Months Ended December 31,	
	2005	2004
Cash flows from operating activities:		
Net loss	\$ (7,092)	\$ (11,514)
Adjustments to reconcile net loss to cash used in operating activities:		
Non cash in-process research & development charge	—	1,653
Depreciation and amortization	950	1,081
Non cash interest expense - accretion of debt discount and amortization of debt issuance costs	—	2,019
Non-cash valuation of marked to market investor warrants	436	—
Fair value of warrants issued for services rendered	1,837	292
Provision for doubtful accounts and sales return allowances	(323)	(138)
Excess and obsolete inventory provision	—	—
Changes in operating assets and liabilities:		
Receivables	(3,506)	(1,513)
Inventories	(1,384)	(1,457)
Prepaid expenses and other assets	(1,834)	(388)
Accounts payable	(145)	1,508
Accrued expenses and other liabilities	(269)	92
Accrued product warranty	159	(138)
Deferred revenue	706	(120)
Net cash used in operating activities	(10,465)	(8,623)
Cash flows used in investing activities:		
Purchases of property and equipment	(211)	(314)
Loss on disposal of property and equipment	128	—
Net cash used in investing activities:	(83)	(314)

Cash flows provided by financing activities:		
Net proceeds from issuance of common stock	18,627	8,595
Borrowings under lines of credit	53	1,136
Repayment of borrowings under lines of credit	(181)	(2,465)
Proceeds from and (payments on) capital lease financing	(9)	(8)
	<u>          </u>	<u>          </u>
Net cash provided by financing activities	18,490	7,258
	<u>          </u>	<u>          </u>
Effect of exchange rates on cash and cash equivalents	76	(26)
	<u>          </u>	<u>          </u>
Net increase (decrease) in cash and cash equivalents	8,018	(1,705)
Cash and cash equivalents at beginning of period	7,093	7,049
	<u>          </u>	<u>          </u>
Cash and cash equivalents at end of period	\$ 15,111	\$ 5,344
	<u>          </u>	<u>          </u>
Supplemental disclosure of non-cash investing and financing activities		
Transfer of demo lab equipment between inventory and fixed assets	\$ 725	—

See accompanying notes.

#### Supplemental Schedule of Non Cash Investing Activities (in thousands, except share data):

On May 28, 2004, Tegal Corporation (the "Company") purchased substantially all of the assets and assumed certain liabilities of First Derivative Systems, Inc. ("FDSI"), a development stage company for 1,410,632 shares of common stock, \$150 in debt forgiveness, approximately \$50 in assumed liabilities, and \$158 in acquisition costs. The purchase price was allocated as follows:

Fair value fixed assets acquired	\$	111
Non compete agreements		203
Patents		733
In-process research and development		1,653
Debt forgiveness		(150)
Assumed liabilities		(50)
		<u>          </u>
	\$	2,500
		<u>          </u>

See accompanying notes.

## TEGAL CORPORATION AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (All amounts in thousands, except share data)

#### 1. Basis of Presentation:

In the opinion of management, the unaudited condensed consolidated interim financial statements have been prepared on the same basis as the March 31, 2005 audited consolidated financial statements and include all adjustments, consisting only of normal recurring adjustments, necessary to fairly state the information set forth herein. The statements have been prepared in accordance with the regulations of the Securities and Exchange Commission (the "SEC"), but omit certain information and footnote disclosures necessary to present the statements in accordance with generally accepted accounting principles. These interim financial statements should be read in conjunction with the consolidated financial statements and footnotes included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2005. The results of operations for the three and nine months ended December 31, 2005 are not necessarily indicative of results to be expected for the entire year.

The consolidated financial statements contemplate the realization of assets and the satisfaction of liabilities in the normal course of business. The Company incurred net losses of \$7,092 and \$11,514 for the nine months ended December 31, 2005 and 2004, respectively. The Company generated negative cash flows from operations of \$10,909 and \$8,623 for the period ended December 31, 2005 and 2004, respectively. During the current Fiscal Year 2006 the Company raised a net of \$18,161 through a private investment placement of equity. Management believes that these proceeds, combined with projected sales, consolidation of certain operations and continued cost containment will be adequate to fund operations through fiscal 2007. However, projected sales may not materialize and unforeseen costs may be incurred. If the projected sales do not materialize, the Company's ability to achieve its intended business objectives may be adversely affected. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets or the amount or classification of liabilities or any other adjustments that might be necessary should the Company be unable to continue as a going concern.

#### Concentration of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of temporary cash investments and accounts receivable. Substantially all of the Company's temporary investments are invested in highly liquid money market funds. The Company's accounts receivables are derived primarily from sales to customers located in the United States, Europe and Asia. The Company performs ongoing credit evaluations of its customers and generally requires no collateral. The Company maintains reserves for potential credit losses. Write-offs during the periods presented have been insignificant. As of December 31, 2005, two customers accounted for approximately 76% of the accounts receivables balance. As of December 31, 2004, one customers accounted for approximately 49% of the accounts receivable balance.

During the three months ended December 31, 2005 and 2004, two customers accounted for 70% and 28% of total revenues, respectively. During the nine months ended December 31, 2005 and December 31, 2004, one customer accounted for 55% and 23% of total revenues, respectively.

## Stock Based Compensation

The Company accounts for stock-based employee compensation under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, (APB No. 25) and related interpretations. Under APB No. 25, compensation cost is equal to the difference, if any, on the date of grant between the fair value of the Company's stock and the amount an employee must pay to acquire the stock. SFAS No. 123, Accounting for Stock-based Compensation, established accounting and disclosure requirements using a fair value based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic value based method of accounting described above, and has adopted the disclosure requirements of SFAS No. 123 and related SFAS No. 148, Accounting for Stock-Based Compensation – Transition and Disclosure.

The following assumptions are included in the estimated grant date fair value calculations for the Company's stock option awards and Employee Qualified Stock Purchase Plan ("Employee Stock Purchase Plan"):

	Three Months Ended December 31, 2005	Nine Months Ended December 31, 2005	Three Months Ended December 31, 2004	Nine Months Ended December 31, 2004
Expected life (years):				
Stock options	4.0	4.0	4.0	4.0
Employee plan	4.0	4.0	4.0	4.0
Volatility:				
Stock options	84%	68%	88%	89%
Employee plan	84%	68%	88%	89%
Risk-free interest rate	3.905	3.905	2.25%	2.25%
Dividend yield	0%	0%	0%	0%

The weighted average estimated grant date fair value, as defined by SFAS No. 123, for stock option awards granted during three months ended December 31, 2005 was \$0.57 per option.

The following table illustrates the effect on net income (loss) and net income (loss) per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation (in thousands, except per share data):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2005	2004	2005	2004
Net loss as reported	\$ (1,904)	\$ (2,688)	\$ (7,092)	\$ (11,514)
Add: Stock-based employee compensation expense included in reported net loss	—	—	—	—
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards	(367)	(396)	(1,447)	(1,037)
Proforma net loss	\$ (2,271)	\$ (3,084)	\$ (8,539)	\$ (12,551)
Basic net loss per share:				
As reported	\$ (0.02)	\$ (0.06)	\$ (0.11)	\$ (0.26)
Proforma	\$ (0.03)	\$ (0.07)	\$ (0.14)	\$ (0.28)

During the nine months ended September 30, 2005, the Company awarded 1,000,000 restricted stock units to Brad Mattson, the Company's Chairman, and 150,000 restricted stock units to Thomas Mika, the Company's President and Chief Executive Officer at the close of the 2005 PIPE, see note 6. These restricted stock units were accounted for as compensation expense of \$1,004.

During the nine months ended September 30, 2005, the Company awarded five employees 400,000 restricted shares. These shares were valued at \$276, are not vested, and were accounted for as Restricted Share Units and Deferred Compensation in the equity section of the balance sheet.

During the previous fiscal year, the Company entered into a contract with certain consultants of the Company pursuant to which the Company will issue warrants on a monthly basis in lieu of cash payments for two years, dependant upon the continuation of the contract and the achievement of certain performance goals. These warrants are valued and expensed on a monthly basis upon issuance. During the three and nine months ending December 31, 2005, the Company issued warrants to purchase 84,999 and 254,997 shares, respectively, of

the Company's common stock to service providers for services rendered. During the three and nine months ended December 31, 2005, the warrants were valued at \$42 and \$179 respectively, using the Black-Scholes model with an exercise price at the market value on the day of the grant and an average interest rate of 3.99% and 3.11% respectively. The life of the warrants is five and seven years with the volatility of 115% and 118%, respectively.

On September 13, 2005 the Company issued 500,000 warrants at \$0.69 as consideration for an amendment to the current lease of the Company's headquarters to reduce the termination fee. The value of the warrants of \$655 was based on the fair value of the termination penalty reduction offset by the exercise price of the warrant and recorded as rent expense.

The disclosure provisions of SFAS No. 123 and SFAS No. 148 require judgments by management as to the estimated lives of the outstanding options. Management has based the estimated life of the options on historical option exercise patterns. If the estimated life of the options increases, the valuation of the options will increase as well.

## 2. Inventories:

Inventories are stated at the lower of cost or market, reduced by provisions for excess and obsolescence. Cost is computed using standard cost, which approximates actual cost on a first-in, first-out basis and includes material, labor and manufacturing overhead costs. We estimate the effects of excess and obsolescence on the carrying values of our inventories based upon estimates of future demand and market conditions. We establish provisions for related inventories in excess of production demand. Should actual production demand differ from our estimates, additional inventory write-downs may be required, as was the case in the fourth quarter of fiscal 2005. Any excess and obsolete provision is released only if and when the related inventories is sold or scrapped. During the three and nine months ending December 31, 2005, the Company sold previously reserved inventory of \$131 and \$440, respectively.

Inventories for the periods presented consisted of:

	December 31, 2005	March 31, 2005
Raw materials	\$ 1,574	\$ 1,044
Work in progress	4,046	2,976
Finished goods and spares	1,750	1,120
	<u>\$ 7,370</u>	<u>\$ 5,140</u>

We periodically analyze any systems that are in finished goods inventory to determine if they are suitable for current customer requirements. At the present time, our policy is that, if after approximately 18 months, we determine that a sale will not take place within the next 12 months and the system would be useable for customer demonstrations or training, it is transferred to fixed assets. Otherwise, it is expensed.

## 3. Product Warranty:

The Company provides warranty on all system sales based on the estimated cost of product warranties at the time revenue is recognized. The warranty obligation is affected by product failure rates, material usage rates, and the efficiency by which the product failure is corrected. Should actual product failure rates, material usage rates and labor efficiencies differ from estimates, revisions to the estimated warranty liability may be required.

Warranty activity for the three-month and nine-month periods ended December 31, 2005 and 2004 was:

	Warranty Activity for the Three Months Ended		Warranty Activity for the Nine Months Ended	
	December 31,		December 31,	
	2005	2004	2005	2004
Balance at the beginning of the period	\$ 315	\$ 251	\$ 252	\$ 366
Additional warranty accruals for warranties issued during the period	234	68	445	298
Accruals related to pre-existing warranties	—	—	—	—
Less settlements made during the period	(124)	(63)	(272)	(408)
Balance at the end of the period	<u>\$ 425</u>	<u>\$ 256</u>	<u>\$ 425</u>	<u>\$ 256</u>

Certain of the Company's sales contracts include provisions under which customers would be indemnified by the Company in the event of, among other things, a third-party claim against the customer for intellectual property rights infringement related to the Company's products. There are no limitations on the maximum potential future payments under these guarantees. The Company has accrued no amounts in relation to these provisions as no such claims have been made and the Company believes it has valid, enforceable rights to the intellectual property embedded in its products.

## 4. Accounting for Restructure Expenses:

During the three months ended December 31, 2005, the Company recorded no severance charges. During the nine months ended December 31, 2005, the Company recorded a severance charge of approximately \$117 related to staff reductions of 5 employees, of which approximately \$24 was classified as cost of sales, \$85 as research and development and \$8 as sales, marketing and general and

administrative expenses. The Company had an outstanding severance liability of approximately \$23 as of December 31, 2005. During the fiscal year ended March 31, 2005, the Company recorded a severance charge of approximately \$129 related to staff reductions of 19 employees, of which approximately \$19 was classified as cost of sales, \$18 as research and development and \$92 as sales, marketing and general and administrative expenses.

## 5. Net Loss Per Common Share:

Basic net loss per common share is computed using the weighted-average number of shares of common stock outstanding.

The following table represents the calculation of basic and diluted net loss per common share (in thousands, except per share data):

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2005	2004	2005	2004
Net loss applicable to common stockholders	\$ (1,904)	\$ (2,688)	\$ (7,092)	\$ (11,514)
Basic and diluted:				
Weighted-average common shares outstanding	83,945	47,733	63,137	45,135
Less weighted-average common shares subject to repurchase	—	—	—	—
Weighted-average common shares used in computing basic and diluted net loss per common share	83,945	47,733	63,137	45,135
Basic and diluted net loss per common share	\$ (0.02)	\$ (0.06)	\$ (0.11)	\$ (0.26)

Outstanding options, warrants and restricted stock equivalent to 30,004,852 and 12,699,823 shares of common stock at a weighted-average exercise price of \$1.27 and \$2.22 per share on December 31, 2005 and 2004, were not included in the computation of diluted net loss per common share for the periods presented as a result of their anti-dilutive effect. Such securities could potentially dilute earnings per share in future periods.

## 6. Stock-Based Transactions:

Effective July 6, 2005, the Company entered into a Purchase Agreement with certain accredited investors pursuant to which it sold to them an aggregate of 30,840,000 shares of our common stock at a purchase price of \$0.65 per share and warrants to purchase an aggregate of 15,420,001 shares of our common stock at an exercise price of \$1.00 per share. All of these securities were sold in a private placement pursuant to Regulation D of the Securities Act of 1933, as amended, solely to accredited investors, as defined in Rule 501 of the Act. This financing transaction is referred to herein as the "2005 PIPE".

In the initial closing of the 2005 PIPE on July 12, 2005, the Company sold 6,300,000 shares at a purchase price of \$0.65 per share and five-year warrants to purchase an aggregate of 3,150,000 shares of common stock at an exercise price of \$1.00 per share to the investors at an aggregate purchase price of \$4,095. In connection with the 2005 PIPE, the Company granted to the investors registration rights. The effective date of the Form S-3 registration statement registering the shares issued in the initial closing was August 25, 2005.

In the second closing of the 2005 PIPE on September 19, 2005, the Company sold 24,540,000 shares at a purchase price of \$.65 per share and five-year warrants to purchase an aggregate of 12,270,001 shares of common stock at an exercise price of \$1.00 per share to the investors at an aggregate purchase price of \$15,951. The effective date of the Form S-3 registration statement registering the shares issued in the second closing was October 24, 2005.

In accordance with EITF 00-19, "Accounting for Derivative Financial Instruments Indexed To, and Potentially Settled In a Company's Own Stock," the fair value of the warrants in the second closing of the 2005 PIPE on the date of grant was estimated to be \$6,621 using the Black-Scholes option-pricing model with the following assumptions: no dividends; risk-free interest rate of 3.5%, the contractual life of 5 years and volatility of 115%. The warrants' fair value was reported as a liability at the time of grant, with a corresponding charge to common stock. At September 30, 2005, the fair value of the warrants was estimated to be \$6,295 using the Black-Scholes option pricing model with the same assumptions. The \$326 decrease in the liability has been reported as other income. The fair value of the warrants was reclassified to common stock when the applicable Form S-3 registration statement became effective on October 24, 2005, with the difference in the fair value of the warrants between September 30, 2005, and the effective date reflected in the statement of operations as other expense of \$762. As of December 31, 2005, there is no longer a contingent liability.

The Company paid a placement fee of \$1,453 (equal to 7% of the Company's gross proceeds for both transactions) to Dahlman Rose & Company LLC, the Company's financial advisor for the 2005 PIPE.

### *Issuance of Warrants to Consultants*

The Company is party to a contract with certain consultants pursuant to which the Company will issue warrants on a monthly basis in lieu of cash payments through August 2006, depending upon the continuation of the contract and the achievement of certain performance goals. The maximum number of warrants to be issued under these agreements is 990,000 shares. During the three and nine months ended December 31, 2005, the warrants were valued at \$42 and \$179 respectively, using the Black-Scholes model with an exercise price at the market value on the day of the grant and an average interest rate of 3.99% and 3.11%, respectively. The life of the warrants is five and seven years with the volatility of 115% and 118%, respectively.

On September 13, 2005 the Company issued 500,000 warrants with an exercise price of \$0.69 per share as consideration for an amendment to the current lease of the Company's headquarters to reduce the termination fee. The value of the warrants of \$655 was based on the fair value of the termination penalty reduction offset by the exercise price of the warrant and recorded as rent expense.

## 7. Lines of Credit:

As of December 31, 2005, the Company's Japanese subsidiary had borrowed 0.1 million yen (approximately \$8 at exchange rates prevailing on December 31, 2005) under its Japanese bank line of credit. The credit line has a total borrowing capacity of 150,000 yen (approximately \$1,271 at exchange rates prevailing on December 31, 2005), which is secured by Japanese customer promissory notes held by such subsidiary in advance of payment on customers' accounts receivable. The Japanese bank line bears interest at Japanese prime (1.375% as of December 31, 2005) plus 1.0%.

Notes payable as of December 31, 2005 consisted primarily of one outstanding note to the California Trade and Commerce Agency for \$22. The unsecured note from the California Trade and Commerce Agency carries an annual interest rate of 5.75% with monthly payments of approximately \$5.5 per month. Although the payment deadlines are being met, the note is currently in technical default due to the merger of Sputtered Films and Tegal Corporation.

## 8. Geographical Information

Tegal operates in one segment for the manufacture, marketing and servicing of integrated circuit fabrication equipment. In accordance with SFAS No. 131 (SFAS 131) "Disclosures About Segments of an Enterprise and Related Information," Tegal's chief operating decision-maker has been identified as the President and Chief Executive Officer, who reviews operating results to make decisions about allocating resources and assessing performance for the entire company. All material operating units qualify for aggregation under SFAS 131 due to their identical customer base and similarities in: economic characteristics; nature of products and services; and procurement, manufacturing and distribution processes. Since Tegal operates in one segment and in one group of similar products and services, all financial segment and product line information required by SFAS 131 can be found in the consolidated financial statements.

For geographical reporting, revenues are attributed to the geographic location in which the customers' facilities are located. Long-lived assets consist primarily of property, plant and equipment, and are attributed to the geographic location in which they are located. Net sales and long-lived assets by geographic region were as follows:

	Revenue for the Three Months Ended December 31,		Revenue for the Nine Months Ended December 31,	
	2005	2004	2005	2004
Sales to customers located in:				
United States	\$ 2,047	\$ 808	\$ 3,790	\$ 2,555
Asia, excluding Japan	2,431	428	2,770	1,231
Japan	768	625	1,846	5,354
Europe	1,000	1,042	7,298	2,192
Total sales	\$ 6,246	\$ 2,903	\$ 15,704	\$ 11,332

	December 31, 2005	March 31, 2005
Long-lived assets at period-end:		
United States	\$ 5,217	\$ 5,112
Europe	17	7
Japan	8	16
Asia, excluding Japan	4	3
Total long-lived assets	\$ 5,246	\$ 5,138

## 9. Comprehensive Income (Loss):

The components of comprehensive loss for the three and nine-month periods ended December 31, 2005 and 2004 are as follows:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2005	2004	2005	2004
Net loss	\$ (1,904)	\$ (2,688)	\$ (7,092)	\$ (11,514)
Foreign currency translation adjustment	228	(277)	621	(192)
	\$ (1,676)	\$ (2,965)	\$ (6,471)	\$ (11,706)

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations



## Special Note Regarding Forward Looking Statements

Information herein contains “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995, which can be identified by the use of forward-looking terminology such as “may,” “will,” “expect,” “anticipate,” “estimate,” or “continue” or the negative thereof or other variations thereon or comparable terminology or which constitute projected financial information. The forward-looking statements relate to the near-term semiconductor capital equipment industry outlook, demand for our products, our quarterly revenue and earnings prospects for the near-term future and other matters contained herein. Such statements are based on current expectations and beliefs and involve a number of uncertainties and risks that could cause the actual results to differ materially from those projected. Such uncertainties and risks include, but are not limited to, cyclicalities of the semiconductor industry, impediments to customer acceptance of our products, fluctuations in quarterly operating results, competitive pricing pressures, the introduction of competitor products having technological and/or pricing advantages, product volume and mix and other risks detailed from time to time in our SEC reports, including in the section entitled “Risk Factors” below. For further information, refer to the business description and risk factors described below. All forward-looking statements are expressly qualified in their entirety by the cautionary statements in this paragraph.

Tegal designs, manufactures, markets and services plasma etch and deposition systems that enable the production of integrated circuits (“ICs”), memory and related microelectronics devices used in personal computers, wireless voice and data telecommunications, contactless transaction devices, radio frequency identification devices (“RFID’s”), smart cards, data storage and micro-level actuators. Etching and deposition constitute two of the principal IC and related device production process steps and each must be performed numerous times in the production of such devices.

## Critical Accounting Policies

Our discussion and analysis of the financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to inventory, warranty obligations, purchase order commitments, bad debts, income taxes, intangible assets, restructuring and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

### Revenue Recognition

Each sale of our equipment is evaluated on an individual basis in regard to revenue recognition. We have integrated in our evaluation the related interpretative guidance included in Topic 13 of the codification of staff accounting bulletins, and recognize the role of the FASB’s Emerging Issues Task Force (“EITF”) consensus on Issue 00-21. We first refer to EITF 00-21 in order to determine if there is more than one unit of accounting and then we refer to SAB104 for revenue recognition topics for the unit of accounting. We recognize revenue when persuasive evidence of an arrangement exists, the seller’s price is fixed or determinable and collectibility is reasonably assured.

For products produced according to our published specifications, where no installation is required or installation is deemed perfunctory and no substantive customer acceptance provisions exist, revenue is recognized when title passes to the customer, generally upon shipment. Installation is not deemed to be essential to the functionality of the equipment since installation does not involve significant changes to the features or capabilities of the equipment or building complex interfaces and connections. In addition, the equipment could be installed by the customer or other vendors and generally the cost of installation approximates only 1% of the sales value of the related equipment.

For products produced according to a particular customer’s specifications, revenue is recognized when the product has been tested and it has been demonstrated that it meets the customer’s specifications and title passes to the customer. The amount of revenue recorded is reduced by the amount (generally 10%), which is not payable by the customer until installation is completed and final customer acceptance is achieved.

For new products, new applications of existing products, or for products with substantive customer acceptance provisions where performance cannot be fully assessed prior to meeting customer specifications at the customer site, 100% of revenue is recognized upon completion of installation and receipt of final customer acceptance. Since title to goods generally passes to the customer upon shipment and 90% of the contract amount becomes payable at that time, inventory is relieved and accounts receivable is recorded for the entire contract amount. The revenue on these transactions is deferred and recorded as deferred revenue. We reserve for warranty costs at the time the related revenue is recognized.

Revenue related to sales of spare parts is recognized upon shipment. Revenue related to maintenance and service contracts is recognized ratably over the duration of the contracts. Unearned maintenance and service revenue is included in other accrued liabilities.

### Accounts Receivable – Allowance for Sales Returns and Doubtful Accounts

We maintain an allowance for doubtful accounts receivable for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, or even a single customer was otherwise unable to make payments, additional allowances may be required.

Our return policy is for spare parts and components only. Customers are allowed to return spare parts if they are defective upon receipt, in accordance with SFAS 48. The potential returns are offset against gross revenue on a monthly basis. Management reviews outstanding requests for returns on a quarterly basis to determine that the reserves are adequate.

## Inventories

Inventories are stated at the lower of cost or market, reduced by provisions for excess and obsolescence. Cost is computed using standard cost, which approximates actual cost on a first-in, first-out basis and includes material, labor and manufacturing overhead costs. We estimate the effects of excess and obsolescence on the carrying values of our inventories based upon estimates of future demand and market conditions. We establish provisions for related inventories in excess of production demand. Should actual production demand differ from our estimates, additional inventory write-downs may be required, as was the case in the fourth quarter of fiscal 2005. Any excess and obsolete provision is released only if and when the related inventories is sold or scrapped.

We periodically analyze any systems that are in finished goods inventory to determine if they are suitable for current customer requirements. At the present time, our policy is that if after approximately 18 months we determine that a sale will not take place within the next 12 months, and the system would be useable for customer demonstrations or training, it is transferred to fixed assets. Otherwise, it is expensed.

The carrying value of systems used for demonstrations or training is determined by assessing the cost of the components that are suitable for sale. Any parts that may be rendered unsaleable as a result of such use are removed from the system and are not included in finished goods inventory. The remaining saleable parts are valued at the lower of cost or market, representing the system's net realizable value. The depreciation period for systems that are transferred to fixed assets is determined based on the age of the system and its remaining useful life (typically five to eight years).

## Impairment of Long-Lived Assets

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If undiscounted expected future cash flows are less than the carrying value of the assets, an impairment loss is recognized based on the excess of the carrying amount over the fair value of the assets.

## Warranty Obligations

We provide for the estimated cost of our product warranties at the time revenue is recognized. Our warranty obligation is affected by product failure rates, material usage rates and the efficiency by which the product failure is corrected. Should actual product failure rates, material usage rates and labor efficiencies differ from our estimates, revisions to the estimated warranty liability may be required.

## Deferred Taxes

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Based on the uncertainty of future taxable income, we have fully reserved our deferred tax assets. In the event we were to determine that we would be able to realize our deferred tax assets in the future, an adjustment to the deferred tax asset would increase income in the period such determination was made.

## Results of Operations

The following table sets forth certain financial items for the three and nine month periods ended December 31, 2005 and 2004:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2005	2004	2005	2004
Revenue	\$ 6,246	\$ 2,903	\$ 15,704	\$ 11,332
Cost of sales	4,565	2,377	10,905	8,105
Gross profit (loss)	1,681	526	4,799	3,227
Operating expenses:				
Research and development	1,039	1,578	3,426	4,243
Sales and marketing	694	704	2,095	2,230
General and administrative	1,128	1,178	5,766	4,771
In-process research and development	—	—	—	1,653
Total operating expenses	2,861	3,460	11,287	12,897
Operating loss	(1,180)	(2,934)	(6,488)	(9,670)
Other income (expense), net				
Interest income (expense), net	142	(2)	166	(2,065)
Other income (expense)	(866)	248	(770)	221

Total other income (expense), net	<u>(724)</u>	<u>246</u>	<u>(604)</u>	<u>(1,844)</u>
Net loss	<u>\$ (1,904)</u>	<u>\$ (2,688)</u>	<u>\$ (7,092)</u>	<u>\$ (11,514)</u>

The following table sets forth certain financial items as a percentage of revenue for the three and nine-month periods ended December 31, 2005 and 2004:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2005	2004	2005	2004
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of sales	73.1	81.9	69.5	71.5
Gross profit (loss)	26.9	18.1	30.5	28.5
Operating expenses:				
Research and development	16.6	54.4	21.8	37.4
Sales and marketing	11.1	24.3	13.3	19.7
General and administrative	18.1	40.5	36.8	42.1
In-process research and development	—	—	—	14.6
Total operating expenses	45.8	119.2	71.9	113.8
Operating loss	(18.9)	(101.1)	(41.4)	(85.3)
Other income, net:				
Interest expense, net	2.3	(0.1)	1.1	(18.2)
Other income (expense), net	(13.9)	8.6	(4.9)	1.9
Other income (expense), net	(11.6)	8.5	(3.8)	(16.3)
Net loss	(30.5%)	(92.6%)	(45.2)%	(101.6%)

*Revenue.* The increase in revenue for the three months ended December 31, 2005 was principally due to the sale of two additional 6500 series systems over the same period of the previous year. The increase in revenue for the nine months ended December 31, 2005 was principally due to the sale of four additional 6500 series systems over the same period of the previous year, offset by the lower revenue associated with a recertified Endeavor compared to a new Endeavor sold in the previous year, and reduced service and spare parts sales. We believe the reduction of service and spare parts sales is a result of reduced usage of our non-critical etch systems by our customers.

International sales as a percentage of the Company's revenue for the three and nine months ended December 31, 2005 were approximately 67% and 76%, respectively, and for the three and nine months ended December 31, 2004 were approximately 72.2% and 77.5%, respectively. We believe that international sales will continue to represent a significant portion of our revenue.

*Gross profit (loss).* Gross profit as a percentage to revenue for the three and nine months ended December 31, 2005 increased by 8.8% and 2.0%, respectively over the comparable periods in 2004. The increase in gross profit as a percentage to revenue, was principally attributable to fixed cost allocated over a larger revenue base.

*Research and development.* Research and development expenses consist primarily of salaries, prototype material and other costs associated with our ongoing systems and process technology development, applications and field process support efforts. The decrease in research and development spending for the three and nine months ended December 31, 2005 resulted from lower license fees, consulting, employee travel, and recruiting expenses as compared to the prior year.

*Sales and marketing.* Sales and marketing expenses consist primarily of salaries, commissions, trade show promotion and travel and living expenses associated with those functions. The decrease in sales and marketing spending for the three and nine months ended December 31, 2005 was primarily due to temporary reduction of personnel which the Company believes will return to previous run rates within the next three to six months, partially offset by commissions paid on sales, as compared to the prior year.

*General and administrative.* General and administrative expenses consist primarily of compensation for general management, accounting and finance, human resources, information systems and investor relations functions and for legal, consulting and accounting fees of the Company. The increase in spending for the nine months ended December 31, 2005 was primarily due to non cash restricted stock units granted and recorded as compensation expense and warrants issued to the landlord of our principal executive offices as compensation for the lease termination fee reduction in addition to \$500 paid as an advance on the termination penalty, offset in part by reduced legal and consulting fees that were associated with the defense of patents and the integration of the acquired companies in the previous period.

*Other income (expense), net.* Other income (expense), net consists principally of, interest income, interest expense, other income, (expense), gains and losses on the disposal of fixed assets, and gains and losses on foreign exchange. We recorded net non-operating expense of \$724 and \$604 during the three-month and nine-month period ended December 31, 2005 respectively. Other expense was principally due to the net mark to market valuation of the investor warrants of \$436 and \$116 loss on the disposal of a fixed asset.

*Contractual obligations.* The following summarizes our contractual obligations at December 31, 2005, and the effect such obligations are expected to have on our liquidity and cash flows in future periods.

Contractual obligations:	Total	Less than			After 5 Years
		1 Year	1-3 Years	3-5 Years	
Non-cancelable capital lease obligations	\$ 17	\$ 12	\$ 5	—	—
Non-cancelable operating lease obligations	4,477	1,328	2,128	1,021	—
Notes payable and bank lines of credit	26	26	—	—	—
<b>Total contractual cash obligations</b>	<b>\$ 4,520</b>	<b>\$ 1,366</b>	<b>\$ 2,133</b>	<b>\$ 1,021</b>	<b>—</b>

Certain sales contracts of the Company include provisions under which customers would be indemnified by the Company in the event of, among other things, a third-party claim against the customer for intellectual property rights infringement related to the Company's products. There are no limitations on the maximum potential future payments under these guarantees. The Company has accrued no amounts in relation to these provisions as no such claims have been made and the Company believes it has valid, enforceable rights to the intellectual property embedded in its products.

## Liquidity and Capital Resources

For the nine-month period ended December 31, 2005, we financed our operations through the use of outstanding cash balances, borrowings against our credit facilities in Japan and net proceeds from the 2005 PIPE.

As of December 31, 2005, our Japanese subsidiary had borrowed 1,000 yen (approximately \$8 at exchange rates prevailing on December 31, 2005) under its Japanese bank line of credit. The credit line has a total borrowing capacity of 150,000 yen (approximately \$1,271 at exchange rates prevailing on December 31, 2005), which is secured by Japanese customer promissory notes held by such subsidiary in advance of payment on customers' accounts receivable. The Japanese bank line bears interest at Japanese prime (1.375% as of December 31, 2005) plus 1.0%.

Notes payable as of December 31, 2005 consisted primarily of one outstanding note to the California Trade and Commerce Agency for \$22. The unsecured note from the California Trade and Commerce Agency carries an annual interest rate of 5.75% with monthly payments of approximately \$5.5 per month. Although the payment deadlines are being met, the note is currently in technical default due to the merger of Sputtered Films and Tegal Corporation.

The consolidated financial statements contemplate the realization of assets and the satisfaction of liabilities in the normal course of business. We incurred net losses of \$7,092 and \$11,514 for the nine months ended December 31, 2005 and 2004, respectively. We generated negative cash flows from operations of \$10,909 and \$8,623 for the period ended December 31, 2005 and 2004, respectively. During the current Fiscal Year 2006, we raised a net of \$18,161 through the 2005 PIPE. Management believes that these proceeds, combined with projected sales, consolidation of certain operations and continued cost containment will be adequate to fund operations through fiscal 2007. However, projected sales may not materialize and unforeseen costs may be incurred. If the projected sales do not materialize, our ability to achieve our intended business objectives may be adversely affected. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets or the amount or classification of liabilities or any other adjustments that might be necessary should we be unable to continue as a going concern.

## Risk Factors

**We have incurred operating losses and may not be profitable in the future; Our plans to maintain and increase liquidity may not be successful; The report of the independent registered public accounting firm includes a going concern uncertainty explanatory paragraph.**

We incurred net losses of \$15.4 million, \$12.6 million and \$12.6 million for the years ended March 31, 2005, 2004 and 2003, respectively, and generated negative cash flows from operations of \$7.5 million, \$3.2 million and \$6.0 million in these respective years. Those factors raised substantial doubt as to our ability to continue as a going concern, and our independent registered public accounting firm included a going concern uncertainty explanatory paragraph in their report dated May 27, 2005 filed with our Annual Report on Form 10-K/A for the year ended March 31, 2005. We have raised approximately \$18.2 million from the sale of stock and warrants in the 2005 PIPE. During fiscal year 2005, we raised approximately \$10.4 million from stock issued to Kingsbridge. Management believes that these proceeds, combined with a projected increase in sales, consolidation of certain operations and continued cost containment will be adequate to fund operations through Fiscal Year 2007. If the projected sales do not materialize, we will need to reduce expenses further and raise additional capital through the issuance of debt or equity securities. If additional funds are raised through the issuance of preferred stock or debt, these securities could have rights, privileges or preferences senior to those of our common stock, and debt covenants could impose restrictions on our operations. Moreover, such financing may not be available to us on acceptable terms, if at all. Failure to raise additional funds may adversely affect our ability to achieve our intended business objectives. Our consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets or the amount or classification of liabilities or any other adjustments that might be necessary should we be unable to continue as a going concern.

**The exercise of outstanding warrants, options and other rights to obtain additional shares will dilute the value of our shares of common stock and could cause the price of our shares of common stock to decline.**

As of December 31, 2005, there were 83,973,854 shares of our common stock issued and outstanding and there were 24,984,318 shares of common stock reserved for issuance under our equity incentive and stock purchase plans.

As of December 31, 2005, there were warrants, stock options and restricted stock units outstanding for approximately 30,004,852, shares of our common stock.

The exercise of these warrants and options and the issuance of the common stock pursuant to our equity incentive plans will result in dilution in the value of the shares of our outstanding common stock and the voting power represented thereby. In addition, the exercise price of the warrants may be lowered under the price adjustment provisions in the event of a "dilutive issuance," that is, if we issue common stock at any time prior to their maturity at a per share price below such conversion or exercise price, either directly or in connection with the issuance of securities that are convertible into, or exercisable for, shares of our common stock. A reduction in the exercise price may result in the issuance of a significant number of additional shares upon the exercise of the warrants.

The warrants do not establish a "floor" that would limit reductions in such conversion price or exercise price. The downward adjustment of the exercise price of these warrants could result in further dilution in the value of the shares of our outstanding common stock and the voting power represented thereby.

No prediction can be made as to the effect, if any, that future sales of shares of our common stock, or the availability of shares for future sale, will have on the market price of our common stock prevailing from time to time. Sales of substantial amounts of shares of our common stock in the public market, or the perception that such sales could occur, may adversely affect the market price of our common stock and may make it more difficult for us to sell our equity securities in the future at a time and price which we deem appropriate.

To the extent our stockholders and the other holders of our warrants and options exercise such securities and then sell the shares of our common stock they receive upon exercise, our stock price may decrease due to the additional amount of shares available in the market. The subsequent sales of these shares could encourage short sales by our securityholders and others, which could place further downward pressure on our stock price. Moreover, holders of these warrants and options may hedge their positions in our common stock by shorting our common stock, which could further adversely affect our stock price.

**If we fail to meet the continued listing requirements of the Nasdaq Stock Market, our stock could be delisted.**

Our stock is currently listed on The Nasdaq Capital Market. The Nasdaq Stock Market's Marketplace Rules impose certain minimum financial requirements on us for the continued listing of our stock. One such requirement is the minimum bid price on our stock of \$1.00 per share. Beginning in 2002, there have been periods of time during which we have been out of compliance with the \$1.00 minimum bid requirements of The Nasdaq Capital Market.

On August 18, 2005, we were notified by the Nasdaq that the bid price of our common stock closed below the minimum \$1.00 per share requirement for continued inclusion under the Nasdaq's Marketplace rules. We have 180 calendar days, or until February 13, 2006, to regain compliance. If, at anytime before February 13, 2006, the bid price of our common stock closes at or above \$1.00 per share for a minimum of 10 consecutive business days, we will regain compliance with the Nasdaq's Marketplace rules. If we do not regain compliance by February 13, 2006, an additional 180 days will be granted to regain compliance, so long as we meet the Nasdaq Capital Market initial listing criteria (except for the bid price requirement).

If we are unable to regain compliance or fall out of compliance in the future with Nasdaq listing requirements, we may take actions in order to achieve compliance, which actions may include a reverse split of our common stock. If an initial delisting decision is made by the Nasdaq's staff, we may appeal the decision as permitted by Nasdaq rules. If we are delisted and cannot obtain listing on another major market or exchange, our stock's liquidity would suffer, and we would likely experience reduced investor interest. Such factors may result in a decrease in our stock's trading price. Delisting also may restrict us from issuing additional securities or securing additional financing.

**The semiconductor industry is cyclical and may experience periodic downturns that may negatively affect customer demand for our products and result in losses such as those experienced in the past.**

Our business depends upon the capital expenditures of semiconductor manufacturers, which in turn depend on the current and anticipated market demand for integrated circuits. The semiconductor industry is highly cyclical and historically has experienced periodic downturns, which often have had a detrimental effect on the semiconductor industry's demand for semiconductor capital equipment, including etch and deposition systems manufactured by us. In response to the current prolonged industry slow-down, we have initiated a substantial cost containment program and completed a corporate-wide restructuring to preserve our cash. However, the need for continued investment in research and development, possible capital equipment requirements and extensive ongoing customer service and support requirements worldwide will continue to limit our ability to reduce expenses in response to these downturns. As a result, we may continue to experience operating losses such as those we have experienced in the past, which could materially adversely affect us.

**Our competitors have greater financial resources and greater name recognition than we do and therefore may compete more successfully in the semiconductor capital equipment industry than we can.**

We believe that to be competitive, we will require significant financial resources in order to offer a broad range of systems, to maintain customer service and support centers worldwide and to invest in research and development. Many of our existing and potential competitors, including, among others, Applied Materials, Inc., Lam Research Corporation, Novellus and Tokyo Electron Limited, have substantially greater financial resources, more extensive engineering, manufacturing, marketing and customer service and support capabilities, larger installed bases of current generation etch, deposition and other production equipment and broader process equipment offerings, as well as greater name recognition than we do. We cannot assure you that we will be able to compete successfully against these companies in the United States or worldwide.

**We depend on sales of our advanced products to customers that may not fully adopt our product for production use.**

We have designed our advanced etch and deposition products for customer applications in emerging new films, polysilicon and metal which we believe to be the leading edge of critical applications for the production of advanced semiconductor and other microelectronic devices. Revenues from the sale of our advanced etch and deposition systems accounted for 30%, 40% and 25% of total revenues in fiscal 2005, 2004 and 2003, respectively. Our advanced systems are currently being used primarily for research and development activities or low volume production. For our advanced systems to achieve full market adoption, our customers must utilize these systems for volume production. We cannot assure you that the market for devices incorporating emerging films, polysilicon or metal will develop as quickly or

to the degree we expect. If our advanced systems do not achieve significant sales or volume production due to a lack of full customer adoption, our business, financial condition, results of operations and cash flows will be materially adversely affected.

**Our potential customers may not adopt our products because of their significant cost or because our potential customers are already using a competitor's tool.**

A substantial investment is required to install and integrate capital equipment into a semiconductor production line. Additionally, we believe that once a device manufacturer has selected a particular vendor's capital equipment, that manufacturer generally relies upon that vendor's equipment for that specific production line application and, to the extent possible, subsequent generations of that vendor's systems. Accordingly, it may be extremely difficult to achieve significant sales to a particular customer once that customer has selected another vendor's capital equipment unless there are compelling reasons to do so, such as significant performance or cost advantages. Any failure to gain access and achieve sales to new customers will adversely affect the successful commercial adoption of our products and could have a detrimental effect on us.

**Our quarterly operating results may continue to fluctuate.**

Our revenue and operating results have fluctuated and are likely to continue to fluctuate significantly from quarter to quarter, and we cannot assure you that we will achieve profitability in the future.

Our 900 series etch systems typically sell for prices ranging between \$250,000 and \$600,000, while prices of our 6500 series critical etch systems and our Endeavor deposition system typically range between \$1.8 million and \$3.0 million. To the extent we are successful in selling our 6500 and Endeavor series systems, the sale of a small number of these systems will probably account for a substantial portion of revenue in future quarters, and a transaction for a single system could have a substantial impact on revenue and gross margin for a given quarter.

Other factors that could affect our quarterly operating results include:

- our timing of new systems and technology announcements and releases and ability to transition between product versions;
- seasonal fluctuations in sales;
- changes in the mix of our revenues represented by our various products and customers;
- adverse changes in the level of economic activity in the United States or other major economies in which we do business;
- foreign currency exchange rate fluctuations;
- expenses related to, and the financial impact of, possible acquisitions of other businesses; and
- changes in the timing of product orders due to unexpected delays in the introduction of our customers' products, due to lifecycles of our customers' products ending earlier than expected or due to market acceptance of our customers' products.

**Some of our sales cycles are lengthy, exposing us to the risks of inventory obsolescence and fluctuations in operating results.**

Sales of our systems depend, in significant part, upon the decision of a prospective customer to add new manufacturing capacity or to expand existing manufacturing capacity, both of which typically involve a significant capital commitment. We often experience delays in finalizing system sales following initial system qualification while the customer evaluates and receives approvals for the purchase of our systems and completes a new or expanded facility. Due to these and other factors, our systems typically have a lengthy sales cycle (often 12 to 18 months in the case of critical etch and deposition systems) during which we may expend substantial funds and management effort. Lengthy sales cycles subject us to a number of significant risks, including inventory obsolescence and fluctuations in operating results over which we have little or no control.

**Because technology changes rapidly, we may not be able to introduce our products in a timely enough fashion.**

The semiconductor manufacturing industry is subject to rapid technological change and new system introductions and enhancements. We believe that our future success depends on our ability to continue to enhance our existing systems and their process capabilities, and to develop and manufacture in a timely manner new systems with improved process capabilities. We may incur substantial unanticipated costs to ensure product functionality and reliability early in our products' life cycles. We cannot assure you that we will be successful in the introduction and volume manufacture of new systems or that we will be able to develop and introduce, in a timely manner, new systems or enhancements to our existing systems and processes which satisfy customer needs or achieve market adoption.

**Our financial performance may adversely affect the morale and performance of our personnel and our ability to hire new personnel.**

Our common stock has declined in value below the exercise price of many options granted to employees pursuant to our stock option plans. Thus, the intended benefits of the stock options granted to our employees, the creation of performance and retention incentives, may not be realized. As a result, we may lose employees whom we would prefer to retain. As a result of these factors, our remaining personnel may seek employment with larger, more established companies or companies perceived as having less volatile stock prices.

**Provisions in our agreements, charter documents, stockholder rights plan and Delaware law may deter takeover attempts, which could decrease the value of your shares.**

Our certificate of incorporation and bylaws and Delaware law contain provisions that could make it more difficult for a third party to acquire us without the consent of our board of directors. Our board of directors has the right to issue preferred stock without stockholder approval, which could be used to dilute the stock ownership of a potential hostile acquirer. Delaware law imposes some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock. In addition, we have adopted a stockholder rights plan that makes it more difficult for a third party to acquire us without the approval of our board of directors. These provisions apply even if the offer may be considered beneficial by some of our stockholders.

**We may not be able to protect our intellectual property or obtain licenses for third parties' intellectual property and therefore we may be exposed to liability for infringement or the risk that our operations may be adversely affected.**

Although we attempt to protect our intellectual property rights through patents, copyrights, trade secrets and other measures, we may not be able to protect our technology adequately and competitors may be able to develop similar technology independently. Additionally, patent applications that we may file may not be issued and foreign intellectual property laws may not protect our intellectual property rights. There is also a risk that patents licensed by or issued to us will be challenged, invalidated or circumvented and that the rights granted thereunder will not provide competitive advantages to us. Furthermore, others may independently develop similar systems, duplicate our systems or design around the patents licensed by or issued to us.

Litigation could result in substantial cost and diversion of effort by us, which by itself could have a detrimental effect on our financial condition, operating results and cash flows. Further, adverse determinations in such litigation could result in our loss of proprietary rights, subject us to significant liabilities to third parties, require us to seek licenses from third parties or prevent us from manufacturing or selling our systems. In addition, licenses under third parties' intellectual property rights may not be available on reasonable terms, if at all.

**Our customers are concentrated and therefore the loss of a significant customer may harm our business.**

Our top five customers accounted for 80.0%, 84.8% and 88.2% of our total revenues in fiscal 2005, 2004 and 2003, respectively. Three customers each accounted for more than 10% of total revenues in fiscal 2005. During the three months ended December 31, 2005, two customers accounted for 70% of total revenues. During the nine months ended December 31, 2005, one customer accounted for 55% of total revenues. Although the composition of the group comprising our largest customers may vary from year to year, the loss of a significant customer or any reduction in orders by any significant customer, including reductions due to market, economic or competitive conditions in the semiconductor manufacturing industry, may have a detrimental effect on our business, financial condition, results of operations and cash flows. Our ability to increase our sales in the future will depend, in part, upon our ability to obtain orders from new customers, as well as the financial condition and success of our existing customers and the general economy, which is largely beyond our ability to control.

**We are exposed to additional risks associated with international sales and operations.**

International sales accounted for 70%, 67% and 66% of total revenue for fiscal 2005, 2004 and 2003, respectively. International sales are subject to certain risks, including the imposition of government controls, fluctuations in the U.S. dollar (which could increase the sales price in local currencies of our systems in foreign markets), changes in export license and other regulatory requirements, tariffs and other market barriers, political and economic instability, potential hostilities, restrictions on the export or import of technology, difficulties in accounts receivable collection, difficulties in managing representatives, difficulties in staffing and managing international operations and potentially adverse tax consequences. We cannot assure you that any of these factors will not have a detrimental effect on our operations, financial results and cash flows.

We generally attempt to offset a portion of our U.S. dollar denominated balance sheet exposures subject to foreign exchange rate remeasurement by purchasing forward currency contracts for future delivery. We cannot assure you that our future results of operations and cash flows will not be adversely affected by foreign currency fluctuations. In addition, the laws of certain countries in which our products are sold may not provide our products and intellectual property rights with the same degree of protection as the laws of the United States.

**Evolving regulation of corporate governance and public disclosure may result in additional expenses and continuing uncertainty.**

Changing laws, regulations and standard relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and Nasdaq Market rules are creating uncertainty for public companies. We continually evaluate and monitor developments with respect to new and proposed rules and cannot predict or estimate the amount of the additional costs we may incur or the timing of such costs. These new or changed laws, regulations and standards are subject to varying interpretations, in many cases due to their lack of specificity, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, we have invested resources to comply with evolving laws, regulations and standards, and this investment may result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, regulatory authorities may initiate legal proceedings against us and we may be harmed.

**Our stock price is volatile and could result in a material decline in the value of your investment in Tegal.**

We believe that factors such as announcements of developments related to our business, fluctuations in our operating results, sales of our common stock into the marketplace, failure to meet or changes in analysts' expectations, general conditions in the semiconductor industry or the worldwide economy, announcements of technological innovations or new products or enhancements by us or our competitors, developments in patents or other intellectual property rights, developments in our relationships with our customers and suppliers, natural disasters and outbreaks of hostilities could cause the price of our common stock to fluctuate substantially. In addition, in recent years the stock market in general, and the market for shares of small capitalization stocks in particular, have experienced extreme price fluctuations, which have often been unrelated to the operating performance of affected companies. We cannot assure you that the market price of our common stock will not experience significant fluctuations in the future, including fluctuations that are unrelated to our performance.

**Potential disruption of our supply of materials required to build our systems could have a negative effect on our operations and damage our customer relationships.**

Materials delays have not been significant in recent years. Nevertheless, we procure certain components and sub-assemblies included

in our systems from a limited group of suppliers, and occasionally from a single source supplier. For example, we depend on MECS Corporation, a robotic equipment supplier, as the sole source for the robotic arm used in all of our 6500 series systems. We currently have no existing supply contract with MECS Corporation, and we currently purchase all robotic assemblies from MECS Corporation on a purchase order basis. Disruption or termination of certain of these sources, including our robotic sub-assembly source, could have an adverse effect on our operations and damage our relationship with our customers.

**Any failure by us to comply with environmental regulations imposed on us could subject us to future liabilities.**

We are subject to a variety of governmental regulations related to the use, storage, handling, discharge or disposal of toxic, volatile or otherwise hazardous chemicals used in our manufacturing process. We believe that we are currently in compliance in all material respects with these regulations and that we have obtained all necessary environmental permits generally relating to the discharge of hazardous wastes to conduct our business. Nevertheless, our failure to comply with present or future regulations could result in additional or corrective operating costs, suspension of production, alteration of our manufacturing processes or cessation of our operations.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Our cash equivalents are principally comprised of money market accounts. As of December 31, 2005, we had cash and cash equivalents of \$15,111. These accounts are subject to interest rate risk and may fall in value if market interest rates increase. We attempt to limit this exposure by investing primarily in short-term securities having a maturity of three months or less. Due to the nature of our cash and cash equivalents, we have concluded that there is no material market risk exposure.

We have foreign subsidiaries that operate and sell our products in various global markets. As a result, our cash flow and earnings are exposed to fluctuations in interest and foreign currency exchange rates. We attempt to limit these exposures through the use of various hedge instruments, primarily forward exchange contracts and currency option contracts (with maturities of less than three months) to manage our exposure associated with firm commitments and net asset and liability positions denominated in non-functional currencies. There have been no material changes regarding market risk since the disclosures made in our Form 10-K for the fiscal year ended March 31, 2005.

At December 31, 2005, the Company had forward exchange contracts maturing at various dates to exchange 296,000 yen into \$2,488.

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**Item 4. Controls and Procedures**

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

(a) *Evaluation of Disclosure Controls and Procedures.* Based on their evaluation as of a date at the end of the quarter covered by this quarterly report on Form 10-Q, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-14(c) under the Securities Exchange Act of 1934) are effective at the reasonable assurance level.

(b) *Changes in Internal Controls.* There has been no change in the Company's internal control over financial reporting during the fiscal quarter ended December 31, 2005 that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting

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**PART II — OTHER INFORMATION**

**Item 1. Legal Proceedings**

Sputtered Films, Inc. v. Advanced Modular Sputtering, et al., filed in Santa Barbara County Superior Court.

On December 22, 2003, Sputtered Films, Inc. ("SFI"), a wholly owned subsidiary of the Company, filed an action against two former employees, Sergey Mishin and Rose Stuart-Curran, and a company they formed after leaving their employment with SFI named Advanced Modular Sputtering, Inc. ("AMS"). Sergey Mishin and Rose Stuart-Curran had each signed confidentiality and non-disclosure agreements regarding information obtained while employed by SFI. The action contains causes of action for specific performance, breach of contract, breach of the covenant of good faith and fair dealing, misappropriation of trade secrets, unfair competition, unfair business practices, interference with prospective economic advantage, conversion, unjust enrichment, and declaratory relief. These claims arise out of information SFI received evidencing that AMS possessed and used SFI's confidential, proprietary and trade secret drawings, specifications and technology to manufacture the sputtering tool marketed by AMS.

The case is now in the discovery phase, and a trial date has been set for September 5, 2006. On November 18, 2005, SFI requested leave to add Agilent Technologies, Inc. ("Agilent") as a defendant based on evidence that Agilent and AMS co-developed the machines which SFI contends were built using SFI proprietary information. The Court granted SFI's request and Agilent was served as a Doe



defendant on December 12, 2005. SFI has learned that Agilent transferred its Semiconductor Products Group to Avago effective December 1, 2005, and as such SFI will seek to add certain Avago entities as defendant in this action.

**Item 6. Exhibits**

*(a) Exhibits*

10.1	Lease between Registrant and BRE/PCCP Orchard, LLC, dated December 21, 2005
10.2	Sublease between Registrant and Silicon Genesis Corporation, dated December 30, 2005
31.1	Certifications of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certifications of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certifications of the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**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.

TEGAL  
CORPORATION  
(Registrant)

/s/ CHRISTINE HERGENROTHER

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Christine Hergenrother  
*Chief Financial Officer*

Dated: February 10, 2006

**LEASE**

**DATED DECEMBER 21, 2005**

**BY AND BETWEEN**

**BRE/PCCP ORCHARD LLC**

**as Landlord**

**and**

**TEGAL CORPORATION**

**as Tenant**

**AFFECTING PREMISES COMMONLY KNOWN AS**

**51 EAST DAGGETT DRIVE**

**SAN JOSE, CALIFORNIA 95134**

**[12/15/95 MULTI TENANT NET INDUSTRIAL LEASE]**

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EXHIBITS

- Exhibit A - Site plan of the Project
- Exhibit B - Improvement Agreement - Not Applicable
- Exhibit C - Approved Specifications - Not Applicable
- Exhibit D - Acceptance Agreement

Exhibit E - Description of Private Restrictions

Exhibit F - Sign Criteria

Exhibit G - Form of Subordination Agreement

Exhibit H - Hazardous Materials Questionnaire

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### SUMMARY OF BASIC LEASE TERMS

SECTION (LEASE REFERENCE)	TERMS
A. (Introduction)	Lease Reference Date: December 21, 2005
B. (Introduction)	Landlord: BRE/PCCP ORCHARD L.L.C. a Delaware limited liability company
C. (Introduction)	Tenant: TEGAL CORPORATION a Delaware corporation
D. (§ 1.21)	Premises: That area consisting of 12,717 square feet of gross leasable area, the address of which is 51 East Daggett Drive, San Jose within the Building as shown on Exhibit A.
E. (§ 1.22)	Project: The land and improvements shown on Exhibit A consisting of 6 buildings, the aggregate gross leasable area of which is 248,835 square feet.
F. (§ 1.7)	Building: The building in which the Premises are located known as Building F containing 39,314 square feet of gross leasable area.
G. (§ 1.29)	Tenant's Share: 32.35% of Building F
H. (§ 4.5)	Tenant's Allocated Parking Stalls: 44 stalls.
I. (§ 1.26)	Scheduled Commencement Date: February 1, 2008
J. (§ 1.18)	Lease Term: 24 calendar months (plus the partial month following the Commencement Date if such date is not the first day of a month).
K. (§ 3.1)	Base Monthly Rent: February 1, 2008 through and including January 31, 2009: \$13,988.70 February 1, 2009 through and including January 31, 2010: \$14,624.55
L. (§ 3.3)	Prepaid Rent: \$13,988.70
M. (§ 3.5)	Security Deposit: \$35,000.00

N. Permitted Use: Research and development, storage and distribution, offices,  
(§ 4.1) marketing, and other legal related uses.

O. Permitted Tenant's Alterations Limit: \$2,500.00  
(§ 5.2)

P. Tenant's Liability Insurance Minimum: \$2,000,000.00  
(§ 9.1)

Q. Landlord's Address: BRE/PCCP Orchard, L.L.C.  
(§ 1.3) c/o Orchard Commercial, Inc.  
2262 North First Street  
San Jose, CA 95131

R. Tenant's Address: Tegal Corporation  
(§ 1.3) 51 East Daggett Drive  
San Jose, CA 95134

S. Retained Real Estate Brokers: Equis  
(§ 15.13) Cornish & Carey Commercial  
Orchard Commercial, Inc.

T. Lease: This Lease includes the summary of the Basic Lease Terms,  
(§ 1.17) the Lease, and the following exhibits and addenda: First Addendum to Lease;  
Exhibit A (site plan of the Project containing description of the Premises),  
Exhibit B (Improvement Agreement), Exhibit C (Approved Specifications), Exhibit  
D (Acceptance Agreement), Exhibit E (description of Private Restrictions),  
Exhibit F (sign criteria), Exhibit G (form of Subordination Agreement), Exhibit  
H (Hazardous Materials Questionnaire).

The foregoing Summary is hereby incorporated into and made part of this Lease. Each reference in this Lease to any term of the Summary shall mean the respective information set forth above shall be construed to incorporate all of the terms provided under the particular paragraph pertaining to such information. In the event of any conflict between the Summary and the Lease, the Summary shall control.

**LANDLORD:**

**TENANT:**

BRE/PCCP ORCHARD, L.L.C.  
a Delaware limited liability company

TEGAL CORPORATION  
a Delaware corporation

By: Orchard 702/703 Investors, LLC  
a Delaware limited liability company, its Member

By: /s/ Thomas R. Mika  
Thomas R. Mika  
[Print Name and Title]

By: /s/ Michael J. Biggar  
Michael J. Biggar  
Managing Member

President & CEO

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

\_\_\_\_\_  
[Print Name and Title]

Dated: 1/4/06

Dated: 12/30/05

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**LEASE**

This Lease is dated as of the lease reference date specified in Section A of the Summary and is made by and between the party identified as Landlord in Section B of the Summary and the party identified as Tenant in Section C of the Summary.

ARTICLE 1

DEFINITIONS

1.1 General: Any initially capitalized term that is given a special meaning by this Article 1, the Summary, or by any other provision of this Lease (including the exhibits attached hereto) shall have such meaning when used in this Lease or any addendum or amendment hereto unless otherwise clearly indicated by the context.

1.2 Additional Rent: The term "Additional Rent" is defined in ¶3.2.

1.3 Address for Notices: The term "Address for Notices" shall mean the addresses set forth in Sections Q and R of the Summary; provided, however, that after the Commencement Date, Tenant's Address for Notices shall be the address of the Premises.

1.4 Agents: The term "Agents" shall mean the following: (i) with respect to Landlord or Tenant, the agents, employees, contractors, and invitees of such party; and (ii) in addition with respect to Tenant, Tenant's subtenants and their respective agents, employees, contractors, and invitees.

1.5 Agreed Interest Rate: The term "Agreed Interest Rate" shall mean that interest rate determined as of the time it is to be applied that is equal to the lesser of (i) 5% in excess of the discount rate established by the Federal Reserve Bank of San Francisco as it may be adjusted from time to time, or (ii) the maximum interest rate permitted by Law.

1.6 Base Monthly Rent: The term "Base Monthly Rent" shall mean the fixed monthly rent payable by Tenant pursuant to ¶3.1 which is specified in Section K of the Summary.

1.7 Building: The term "Building" shall mean the building in which the Premises are located which Building is identified in Section F of the Summary, the gross leasable area of which is referred to herein as the "Building Gross Leasable Area."

1.8 Commencement Date: The term "Commencement Date" is the date the Lease Term commences, which term is defined in ¶2.2.

1.9 Common Area: The term "Common Area" shall mean all areas and facilities within the Project that are not designated by Landlord for the exclusive use of Tenant or any other lessee or other occupant of the Project, including the parking areas, access and perimeter roads, pedestrian sidewalks, landscaped areas, trash enclosures, recreation areas and the like.

1.10 Common Operating Expenses: The term "Common Operating Expenses" is defined in ¶8.2.

1.11 Consumer Price Index: The term "Consumer Price Index" shall refer to the Consumer Price Index, All Urban Consumers, subgroup "All Items", for the San Francisco-Oakland-San Jose metropolitan area (base year 1982-84 equals 100), which is presently being published monthly by the United States Department of Labor, Bureau of Labor Statistics. However, if this Consumer Price Index is changed so that the base year is altered from that used as of the commencement of the initial term of this Lease, the Consumer Price Index shall be converted in accordance with the conversion factor published by the United States Department of Labor, Bureau of Labor Statistics to obtain the same results that would have been obtained had the base year not been changed. If no conversion factor is available, or if the Consumer Price Index is otherwise changed, revised or discontinued for any reason, there shall be substituted in lieu thereof and the term "Consumer Price Index" shall thereafter refer to the most nearly comparable official price index of the United States government in order to obtain substantially the same result as would have been obtained had the original Consumer Price Index not been discontinued, revised or changed, which alternative index shall be selected by Landlord and shall be subject to Tenant's written approval.

1.12 Effective Date: The term "Effective Date" shall mean the date the last signatory to this Lease whose execution is required to make it binding on the parties hereto shall have executed this Lease.

1.13 Event of Tenant's Default: The term "Event of Tenant's Default" is defined in ¶13.1.

1.14 Hazardous Materials: The terms "Hazardous Materials" and "Hazardous Materials Laws" are defined in ¶7.2E.

1.15 Insured and Uninsured Peril: The terms "Insured Peril" and "Uninsured Peril" are defined in ¶11.2E.

1.16 Law: The term "Law" shall mean any judicial decision, statute, constitution, ordinance, resolution, regulation, rule, administrative order, or other requirement of any municipal, county, state, federal or other government agency or authority having jurisdiction over the parties to this Lease or the Premises, or both, in effect either at the Effective Date or any time during the Lease Term.

1.17 Lease: The term "Lease" shall mean the Summary and all elements of this Lease identified in Section T of the Summary, all of which are attached hereto and incorporated herein by this reference.

1.18 Lease Term: The term "Lease Term" shall mean the term of this Lease which shall commence on the Commencement Date and continue for the period specified in Section J of the Summary.

1.19 Lender: The term "Lender" shall mean any beneficiary, mortgagee, secured party, lessor, or other holder of any Security Instrument.

1.20 Permitted Use: The term "Permitted Use" shall mean the use specified in Section N of the Summary.

1.21 Premises: The term "Premises" shall mean that building area described in Section D of the Summary that is within the Building.

1.22 Project: The term "Project" shall mean that real property and the improvements thereon which are specified in Section E of the Summary, the aggregate gross leasable area of which is referred to herein as the "Project Gross Leasable Area."

1.23 Private Restrictions: The term "Private Restrictions" shall mean all recorded covenants, conditions and restrictions, private agreements, reciprocal easement agreements, and any other recorded instruments affecting the use of the Premises which (i) exist as of the Effective Date, or (ii) are recorded after the Effective Date and are approved by Tenant.

1.24 Real Property Taxes: The term "Real Property Taxes" is defined in ¶8.3.

1.25 Scheduled Commencement Date: The term "Scheduled Commencement Date" shall mean the date specified in Section I of the Summary.

1.26 Security Instrument: The term "Security Instrument" shall mean any underlying lease, mortgage or deed of trust which now or hereafter affects the Project, and any renewal, modification, consolidation, replacement or extension thereof.

1.27 Summary: The term "Summary" shall mean the Summary of Basic Lease Terms executed by Landlord and Tenant that is part of this Lease.

1.28 Tenant's Alterations: The term "Tenant's Alterations" shall mean all improvements, additions, alterations, and fixtures installed in the Premises by Tenant at its expense which are not Trade Fixtures.

1.29 Tenant's Share: The term "Tenant's Share" shall mean the percentage obtained by dividing Tenant's Gross Leasable Area by the Building Gross Leasable Area, which as of the Effective Date is the percentage identified in Section G of the Summary.

1.30 Trade Fixtures: The term "Trade Fixtures" shall mean (i) Tenant's inventory, furniture, signs, and business equipment, and (ii) anything affixed to the Premises by Tenant at its expense for purposes of trade, manufacture, ornament or domestic use (except replacement of similar work or material originally installed by Landlord) which can be removed without material injury to the Premises unless such thing has, by the manner in which it is affixed, become an integral part of the Premises.

## ARTICLE 2

### DEMISE, CONSTRUCTION, AND ACCEPTANCE

2.1 Demise of Premises: Landlord hereby leases to Tenant, and Tenant leases from Landlord, for the Lease Term upon the terms and conditions of this Lease, the Premises for Tenant's own use in the conduct of Tenant's business together with (i) the non-exclusive right to use the number of Tenant's Allocated Parking Stalls within the Common Area (subject to the limitations set forth in ¶4.5), and (ii) the non-exclusive right to use the Common Area for ingress to and egress from the Premises. Landlord reserves the use of the exterior walls, the roof and the area beneath and above the Premises, together with the right to install, maintain, use, and replace ducts, wires, conduits and pipes leading through the Premises in locations which will not materially interfere with Tenant's use of the Premises.

2.2 Commencement Date: If Landlord is not obligated to construct improvements prior to the Commencement Date pursuant to ¶2.3, then on the Scheduled Commencement Date Landlord shall deliver possession of the Premises to Tenant and the Lease Term shall commence, and such date shall be referred to herein as the "Commencement Date". If Landlord is required to construct improvements to the Premises prior to the Commencement Date, then the Scheduled Commencement Date shall be only an estimate of the actual Commencement Date, and the term of this Lease shall begin on the first to occur of the following, which shall be the "Commencement Date": (i) the date Landlord offers to deliver possession of the Premises to Tenant following substantial completion of all improvements to be constructed by Landlord pursuant to ¶2.3 except for punchlist items which do not prevent Tenant from using the Premises for the Permitted Use and such work as Landlord is required to perform but cannot complete until Tenant performs necessary portions of construction work it has elected or is required to do; or (ii) the date Tenant enters into occupancy of the Premises.

2.3 Construction of Improvements: Prior to the Commencement Date, Landlord shall construct certain improvements that shall constitute or become part of the Premises if required by, and then in accordance with, the terms of Exhibit B and Exhibit C.

2.4 Delivery and Acceptance of Possession: If this Lease provides that Landlord must deliver possession of the Premises to Tenant on a certain date, then if Landlord is unable to deliver possession of the Premises to Tenant on or before such date for any reason whatsoever, this Lease shall not be void or voidable for a period of 180 days thereafter, and Landlord shall not be liable to Tenant for any loss or damage resulting therefrom. Tenant shall accept possession and enter into good faith occupancy of the entire Premises and commence the operation of its business therein within 30 days after the Commencement Date. Tenant acknowledges that it has had an opportunity to conduct, and has conducted, such inspections of the Premises as it deems necessary to evaluate its condition. Except as otherwise specifically provided herein, Tenant agrees to accept possession of the Premises in its then existing condition, "as-is", including all patent and latent defects. Tenant's taking possession of any part of the Premises shall be deemed to be an acceptance by Tenant of any work of improvement done by Landlord in such part as complete and in accordance with the terms of this Lease except for defects of which Tenant has given Landlord written notice prior to the time Tenant takes possession. At the time Landlord delivers possession of the Premises to Tenant, Landlord and Tenant shall together execute an acceptance agreement in the form attached as Exhibit D, appropriately completed. Landlord shall have no obligation to deliver possession, nor shall Tenant be entitled to take occupancy, of the Premises until such acceptance agreement has been executed, and Tenant's obligation to pay Base Monthly Rent and Additional Rent shall not be excused or delayed because of Tenant's failure to execute such acceptance agreement.

2.5 Early Occupancy: If Tenant enters or permits its contractors to enter the Premises prior to the Commencement Date with the written permission of Landlord, it shall do so upon all of the terms of this Lease (including its obligations regarding indemnity and insurance) except those regarding the obligation to pay rent, which shall commence on the Commencement Date.

## ARTICLE 3

### RENT

3.1 Base Monthly Rent: Commencing on the Commencement Date and continuing throughout the Lease Term, Tenant shall pay to Landlord the Base Monthly Rent set forth in Section K of the Summary.

3.2 Additional Rent: Commencing on the Commencement Date and continuing throughout the Lease Term, Tenant shall pay the following as additional rent (the "Additional Rent"): (i) any late charges or interest due Landlord pursuant to ¶3.4; (ii) Tenant's Share of Common Operating Expenses as provided in ¶8.1; (iii) Landlord's share of any Subrent received by Tenant upon certain assignments and



sublettings as required by ¶14.1; (iv) any legal fees and costs due Landlord pursuant to ¶15.9; and (v) any other charges due Landlord pursuant to this Lease.

3.3 **Payment of Rent:** Concurrently with the execution of this Lease by both parties, Tenant shall pay to Landlord the amount set forth in Section L of the Summary as prepayment of rent for credit against the first installment(s) of Base Monthly Rent. All rent required to be paid in monthly installments shall be paid in advance on the first day of each calendar month during the Lease Term. If Section K of the Summary provides that the Base Monthly Rent is to be increased during the Lease Term and if the date of such increase does not fall on the first day of a calendar month, such increase shall become effective on the first day of the next calendar month. All rent shall be paid in lawful money of the United States, without any abatement, deduction or offset whatsoever (except as specifically provided in ¶11.4 and ¶12.3), and without any prior demand therefor. Rent shall be paid to Landlord at its address set forth in Section Q of the Summary, or at such other place as Landlord may designate from time to time. Tenant's obligation to pay Base Monthly Rent and Tenant's Share of Common Operating Expenses shall be prorated at the commencement and expiration of the Lease Term.

3.4 **Late Charge and Interest on Rent in Default:** If any Base Monthly Rent or Additional Rent is not received by Landlord from Tenant within three (3) business days after Landlord has notified Tenant in writing that payment of such rent has not been received by Landlord, then Tenant shall immediately pay to Landlord a late charge equal to 5% of such delinquent rent as liquidated damages for Tenant's failure to make timely payment. In no event shall this provision for a late charge be deemed to grant to Tenant a grace period or extension of time within which to pay any rent or prevent Landlord from exercising any right or remedy available to Landlord upon Tenant's failure to pay any rent due under this Lease in a timely fashion, including any right to terminate this Lease pursuant to ¶13.2C. If any rent remains delinquent for a period in excess of 30 days then, in addition to such late charge, Tenant shall pay to Landlord interest on any rent that is not paid when due at the Agreed Interest Rate following the date such amount became due until paid.

3.5 **Security Deposit:** On the Effective Date, Tenant shall deposit with Landlord the amount set forth in Section M of the Summary as security for the performance by Tenant of its obligations under this Lease, and not as prepayment of rent (the "Security Deposit"). Landlord may from time to time apply such portion of the Security Deposit as is reasonably necessary for the following purposes: (i) to remedy any default by Tenant in the payment of rent; (ii) to repair damage to the Premises caused by Tenant; (iii) to clean the Premises upon termination of the Lease; and (iv) to remedy any other default of Tenant to the extent permitted by Law and, in this regard, Tenant hereby waives any restriction on the uses to which the Security Deposit may be put contained in California Civil Code Section 1950.7. In the event the Security Deposit or any portion thereof is so used, Tenant agrees to pay to Landlord promptly upon demand an amount in cash sufficient to restore the Security Deposit to the full original amount. Landlord shall not be deemed a trustee of the Security Deposit, may use the Security Deposit in business, and shall not be required to segregate it from its general accounts. Tenant shall not be entitled to any interest on the Security Deposit. If Landlord transfers the Premises during the Lease Term, Landlord may pay the Security Deposit to any transferee of Landlord's interest in conformity with the provisions of California Civil Code Section 1950.7 and/or any successor statute, in which event the transferring Landlord will be released from all liability for the return of the Security Deposit.

## ARTICLE 4

### USE OF PREMISES

4.1 **Limitation on Use:** Tenant shall use the Premises solely for the Permitted Use specified in Section N of the Summary. Tenant shall not do anything in or about the Premises which will (i) cause structural injury to the Building, or (ii) cause damage to any part of the Building except to the extent reasonably necessary for the installation of Tenant's Trade Fixtures and Tenant's Alterations, and then only in a manner which has been first approved by Landlord in writing. Tenant shall not operate any equipment within the Premises which will (i) materially damage the Building or the Common Area, (ii) overload existing electrical systems or other mechanical equipment servicing the Building, (iii) impair the efficient operation of the sprinkler system or the heating, ventilating or air conditioning ("HVAC") equipment within or servicing the Building, or (iv) damage, overload or corrode the sanitary sewer system. Tenant shall not attach, hang or suspend anything from the ceiling, roof, walls or columns of the Building or set any load on the floor in excess of the load limits for which such items are designed nor operate hard wheel forklifts within the Premises. Any dust, fumes, or waste products generated by Tenant's use of the Premises shall be contained and disposed so that they do not (i) create an unreasonable fire or health hazard, (ii) damage the Premises, or (iii) result in the violation of any Law. Except as approved by Landlord, Tenant shall not change the exterior of the Building or install any equipment or antennas on or make any penetrations of the exterior or roof of the Building. Tenant shall not commit any waste in or about the Premises, and Tenant shall keep the Premises in a neat, clean, attractive and orderly condition, free of any nuisances. If Landlord designates a standard window covering for use throughout the Building, Tenant shall use this standard window covering to cover all windows in the Premises. Tenant shall not conduct on any portion of the Premises or the Project any sale of any kind, including any public or private auction, fire sale, going-out-of-business sale, distress sale or other liquidation sale.

4.2 **Compliance with Regulations:** Tenant shall not use the Premises in any manner which violates any Laws or Private Restrictions which affect the Premises. Tenant shall abide by and promptly observe and comply with all Laws and Private Restrictions. Tenant shall not use the Premises in any manner which will cause a cancellation of any insurance policy covering Tenant's Alterations or any improvements installed by Landlord at its expense or which poses an unreasonable risk of damage or injury to the Premises. Tenant shall not sell, or permit to be kept, used, or sold in or about the Premises any article which may be prohibited by the standard form of fire insurance policy. Tenant shall comply with all reasonable requirements of any insurance company, insurance underwriter, or Board of Fire Underwriters which are necessary to maintain the insurance coverage carried by either Landlord or Tenant pursuant to this Lease.

4.3 **Outside Areas:** No materials, supplies, tanks or containers, equipment, finished products or semi-finished products, raw materials, inoperable vehicles or articles of any nature shall be stored upon or permitted to remain outside of the Premises except in fully fenced and screened areas outside the Building which have been designed for such purpose and have been approved in writing by Landlord for such use by Tenant.

4.4 **Signs:** Tenant shall not place on any portion of the Premises any sign, placard, lettering in or on windows, banner, displays or other advertising or communicative material which is visible from the exterior of the Building without the prior written approval of Landlord. All such approved signs shall strictly conform to all Laws, Private Restrictions, and Landlord's sign criteria attached as Exhibit F, and shall be installed at the expense of Tenant. Tenant shall maintain such signs in good condition and repair.

4.5 Parking: Tenant is allocated and shall have the non-exclusive right to use not more than the number of Tenant's Allocated Parking Stalls contained within the Project described in Section H of the Summary for its use and the use of Tenant's Agents, the location of which may be designated from time to time by Landlord. Tenant shall not at any time use more parking spaces than the number so allocated to Tenant or park its vehicles or the vehicles of others in any portion of the Project not designated by Landlord as a non-exclusive parking area. Tenant shall not have the exclusive right to use any specific parking space. If Landlord grants to any other tenant the exclusive right to use any particular parking space(s), Tenant shall not use such spaces. Landlord reserves the right, after having given Tenant reasonable notice, to have any vehicles owned by Tenant or Tenant's Agents utilizing parking spaces in excess of the parking spaces allowed for Tenant's use to be towed away at Tenant's cost. All trucks and delivery vehicles shall be (i) parked at the rear of the Building, (ii) loaded and unloaded in a manner which does not interfere with the businesses of other occupants of the Project, and (iii) permitted to remain on the Project only so long as is reasonably necessary to complete loading and unloading. In the event Landlord elects or is required by any Law to limit or control parking in the Project, whether by validation of parking tickets or any other method of assessment, Tenant agrees to participate in such validation or assessment program under such reasonable rules and regulations as are from time to time established by Landlord.

4.6 Rules and Regulations: Landlord may from time to time promulgate reasonable and nondiscriminatory rules and regulations applicable to all occupants of the Project for the care and orderly management of the Project and the safety of its tenants and invitees. Such rules and regulations shall be binding upon Tenant upon delivery of a copy thereof to Tenant, and Tenant agrees to abide by such rules and regulations. If there is a conflict between the rules and regulations and any of the provisions of this Lease, the provisions of this Lease shall prevail. Landlord shall not be responsible for the violation by any other tenant of the Project of any such rules and regulations.

## ARTICLE 5

### TRADE FIXTURES AND ALTERATIONS

5.1 Trade Fixtures: Throughout the Lease Term, Tenant may provide and install, and shall maintain in good condition, any Trade Fixtures required in the conduct of its business in the Premises. All Trade Fixtures shall remain Tenant's property.

5.2 Tenant's Alterations: Construction by Tenant of Tenant's Alterations shall be governed by the following:

A. Tenant shall not construct any Tenant's Alterations or otherwise alter the Premises without Landlord's prior written approval. Tenant shall be entitled, without Landlord's prior approval, to make Tenant's Alterations (i) which do not affect the structural or exterior parts or water tight character of the Building, and (ii) the reasonably estimated cost of which, plus the original cost of any part of the Premises removed or materially altered in connection with such Tenant's Alterations, together do not exceed the Permitted Tenant Alterations Limit specified in Section O of the Summary per work of improvement. In the event Landlord's approval for any Tenant's Alterations is required, Tenant shall not construct the Leasehold Improvement until Landlord has approved in writing the plans and specifications therefor, and such Tenant's Alterations shall be constructed substantially in compliance with such approved plans and specifications by a licensed contractor first approved by Landlord. All Tenant's Alterations constructed by Tenant shall be constructed by a licensed contractor in accordance with all Laws using new materials of good quality.

B. Tenant shall not commence construction of any Tenant's Alterations until (i) all required governmental approvals and permits have been obtained, (ii) all requirements regarding insurance imposed by this Lease have been satisfied, (iii) Tenant has given Landlord at least five days' prior written notice of its intention to commence such construction, and (iv) if reasonably requested by Landlord, Tenant has obtained contingent liability and broad form builders' risk insurance in an amount reasonably satisfactory to Landlord if there are any perils relating to the proposed construction not covered by insurance carried pursuant to Article 9.

C. All Tenant's Alterations shall remain the property of Tenant during the Lease Term but shall not be altered or removed from the Premises. At the expiration or sooner termination of the Lease Term, all Tenant's Alterations shall be surrendered to Landlord as part of the realty and shall then become Landlord's property, and Landlord shall have no obligation to reimburse Tenant for all or any portion of the value or cost thereof; provided, however, that if Landlord requires Tenant to remove any Tenant's Alterations, Tenant shall so remove such Tenant's Alterations prior to the expiration or sooner termination of the Lease Term. Notwithstanding the foregoing, Tenant shall not be obligated to remove any Tenant's Alterations with respect to which the following is true: (i) Tenant was required, or elected, to obtain the approval of Landlord to the installation of the Leasehold Improvement in question; (ii) at the time Tenant requested Landlord's approval, Tenant requested of Landlord in writing that Landlord inform Tenant of whether or not Landlord would require Tenant to remove such Leasehold Improvement at the expiration of the Lease Term; and (iii) at the time Landlord granted its approval, it did not inform Tenant that it would require Tenant to remove such Leasehold Improvement at the expiration of the Lease Term.

5.3 Alterations Required by Law: Tenant shall make any alteration, addition or change of any sort to the Premises that is required by any Law because of (i) Tenant's particular use or change of use of the Premises; (ii) Tenant's application for any permit or governmental approval; or (iii) Tenant's construction or installation of any Tenant's Alterations or Trade Fixtures. Any other alteration, addition, or change required by Law which is not the responsibility of Tenant pursuant to the foregoing shall be made by Landlord (subject to Landlord's right to reimbursement from Tenant specified in ¶5.4).

5.4 Amortization of Certain Capital Improvements: Tenant shall pay Additional Rent in the event Landlord reasonably elects or is required to make any of the following kinds of capital improvements to the Project and the cost thereof is not reimbursable as a Common Operating Expense: (i) capital improvements required to be constructed in order to comply with any Law (excluding any Hazardous Materials Law) not in effect or applicable to the Project as of the Effective Date; (ii) modification of existing or construction of additional capital improvements or building service equipment for the purpose of reducing the consumption of utility services or Common Operating Expenses of the Project, **so long as the amortized cost of the improvement does not exceed the savings generated unless such improvement is required by governmental authority**; (iii) replacement of capital improvements or building service equipment existing as of the Effective Date when required because of normal wear and tear; and (iv) restoration of any part of the Project that has been damaged by any peril to the extent the cost thereof is not covered by insurance proceeds actually recovered by Landlord up to a maximum amount per occurrence of 10% of the then replacement cost of the Project. The amount of Additional Rent Tenant is to pay with respect to each such capital improvement shall be determined as follows:

A. All costs paid by Landlord to construct such improvements (including financing costs) shall be amortized over the useful life of such improvement (as reasonably determined by Landlord in accordance with generally accepted accounting principles) with interest on the unamortized balance at the then prevailing market rate Landlord would pay if it borrowed funds to construct such improvements from an institutional lender, and Landlord shall inform Tenant of the monthly amortization payment required to so amortize such costs, and shall also provide Tenant with the information upon which such determination is made.

B. As Additional Rent, Tenant shall pay at the same time the Base Monthly Rent is due an amount equal to Tenant's Share of that portion of such monthly amortization payment fairly allocable to the Building (as reasonably determined by Landlord) for each month after such improvements are completed until the first to occur of (i) the expiration of the Lease Term (as it may be extended), or (ii) the end of the term over which such costs were amortized.

5.5 Mechanic's Liens: Tenant shall keep the Project free from any liens and shall pay when due all bills arising out of any work performed, materials furnished, or obligations incurred by Tenant or Tenant's Agents relating to the Project. If any claim of lien is recorded (except those caused by Landlord or Landlord's Agents), Tenant shall bond against or discharge the same within 10 days after the same has been recorded against the Project. Should any lien be filed against the Project or any action be commenced affecting title to the Project, the party receiving notice of such lien or action shall immediately give the other party written notice thereof.

5.6 Taxes on Tenant's Property: Tenant shall pay before delinquency any and all taxes, assessments, license fees and public charges levied, assessed or imposed against Tenant or Tenant's estate in this Lease or the property of Tenant situated within the Premises which become due during the Lease Term. If any tax or other charge is assessed by any governmental agency because of the execution of this Lease, such tax shall be paid by Tenant. On demand by Landlord, Tenant shall furnish Landlord with satisfactory evidence of these payments.

## ARTICLE 6

### REPAIR AND MAINTENANCE

6.1 Tenant's Obligation to Maintain: Except as otherwise provided in ¶6.2, ¶11.1, and ¶12.3, Tenant shall be responsible for the following during the Lease Term:

A. Tenant shall clean and maintain in good order, condition, and repair and replace when necessary the Premises and every part thereof, through regular inspections and servicing, including, but not limited to: (i) all plumbing and sewage facilities (including all sinks, toilets, faucets and drains), and all ducts, pipes, vents or other parts of the HVAC or plumbing system; (ii) all fixtures, interior walls, floors, carpets and ceilings; (iii) all windows, doors, entrances, plate glass, showcases and skylights (including cleaning both interior and exterior surfaces); (iv) all electrical facilities and all equipment (including all lighting fixtures, lamps, bulbs, tubes, fans, vents, exhaust equipment and systems); and (v) any automatic fire extinguisher equipment in the Premises.

B. With respect to utility facilities serving the Premises (including electrical wiring and conduits, gas lines, water pipes, and plumbing and sewage fixtures and pipes), Tenant shall be responsible for the maintenance and repair of any such facilities which serve only the Premises, including all such facilities that are within the walls or floor, or on the roof of the Premises, and any part of such facility that is not within the Premises, but only up to the point where such facilities join a main or other junction (e.g., sewer main or electrical transformer) from which such utility services are distributed to other parts of the Project as well as to the Premises. Tenant shall replace any damaged or broken glass in the Premises (including all interior and exterior doors and windows) with glass of the same kind, size and quality. Tenant shall repair any damage to the Premises (including exterior doors and windows) caused by vandalism or any unauthorized entry.

C. Tenant shall (i) maintain, repair and replace when necessary all **building standard or Landlord installed** HVAC equipment which services only the Premises, and shall keep the same in good condition through regular inspection and servicing, and (ii) maintain continuously throughout the Lease Term a service contract for the maintenance of all such HVAC equipment with a licensed HVAC repair and maintenance contractor approved by Landlord, which contract provides for the periodic inspection and servicing of the HVAC equipment at least once every **90** days during the Lease Term. Notwithstanding the foregoing, Landlord may elect at any time to assume responsibility for the maintenance, repair and replacement of such HVAC equipment which serves only the Premises. Tenant shall maintain continuously throughout the Lease Term a service contract for the washing of all windows (both interior and exterior surfaces) in the Premises with a contractor approved by Landlord, which contract provides for the periodic washing of all such windows at least once every 60 days during the Lease Term. Tenant shall furnish Landlord with copies of all such service contracts, which shall provide that they may not be cancelled or changed without at least 30 days' prior written notice to Landlord.

D. All repairs and replacements required of Tenant shall be promptly made with new materials of like kind and quality. If the work affects the structural parts of the Building or if the estimated cost of any item of repair or replacement is in excess of the Permitted Tenant's Alterations Limit, then Tenant shall first obtain Landlord's written approval of the scope of the work, plans therefor, materials to be used, and the contractor.

6.2 Landlord's Obligation to Maintain: Landlord shall repair, maintain and operate the Common Area and repair and maintain the roof, exterior and structural parts of the building(s) located on the Project so that the same are kept in good order and repair. If there is central HVAC or other building service equipment and/or utility facilities serving portions of the Common Area and/or both the Premises and other parts of the Building, Landlord shall maintain and operate (and replace when necessary) such equipment. Landlord shall not be responsible for repairs required by an accident, fire or other peril or for damage caused to any part of the Project by any act or omission of Tenant or Tenant's Agents except as otherwise required by Article 11. Landlord may engage contractors of its choice to perform the obligations required of it by this Article, and the necessity of any expenditure to perform such obligations shall be at the **reasonable but** sole discretion of Landlord.

6.3 Control of Common Area: Landlord shall at all times have exclusive control of the Common Area. Landlord shall have the right, without the same constituting an actual or constructive eviction and without entitling Tenant to any abatement of rent, to: (i) close any part

of the Common Area to whatever extent required in the opinion of Landlord's counsel to prevent a dedication thereof or the accrual of any prescriptive rights therein; (ii) temporarily close the Common Area to perform maintenance or for any other reason deemed sufficient by Landlord; (iii) change the shape, size, location and extent of the Common Area; (iv) eliminate from or add to the Project any land or improvement, including multi-deck parking structures; (v) make changes to the Common Area including, without limitation, changes in the location of driveways, entrances, passageways, doors and doorways, elevators, stairs, restrooms, exits, parking spaces, parking areas, sidewalks or the direction of the flow of traffic and the site of the Common Area; (vi) remove unauthorized persons from the Project; and/or (vii) change the name or address of the Building or Project. Tenant shall keep the Common Area clear of all obstructions created or permitted by Tenant. If in the opinion of Landlord unauthorized persons are using any of the Common Area by reason of the presence of Tenant in the Building, Tenant, upon demand of Landlord, shall restrain such unauthorized use by appropriate proceedings. In exercising any such rights regarding the Common Area, (i) Landlord shall make a reasonable effort to minimize any disruption to Tenant's business, and (ii) Landlord shall not exercise its rights to control the Common Area in a manner that would materially interfere with Tenant's use of the Premises without first obtaining Tenant's consent. Landlord shall have no obligation to provide guard services or other security measures for the benefit of the Project. Tenant assumes all responsibility for the protection of Tenant and Tenant's Agents from acts of third parties; provided, however, that nothing contained herein shall prevent Landlord, at its sole option, from providing security measures for the Project.

## ARTICLE 7

### WASTE DISPOSAL AND UTILITIES

7.1 Waste Disposal: Tenant shall store its waste either inside the Premises or within outside trash enclosures that are fully fenced and screened in compliance with all Private Restrictions, and designed for such purpose. All entrances to such outside trash enclosures shall be kept closed, and waste shall be stored in such manner as not to be visible from the exterior of such outside enclosures. Tenant shall cause all of its waste to be regularly removed from the Premises at Tenant's sole cost. Tenant shall keep all fire corridors and mechanical equipment rooms in the Premises free and clear of all obstructions at all times.

7.2 Hazardous Materials: Landlord and Tenant agree as follows with respect to the existence or use of Hazardous Materials on the Project:

A. Any handling, transportation, storage, treatment, disposal or use of Hazardous Materials by Tenant and Tenant's Agents after the Effective Date in or about the Project shall strictly comply with all applicable Hazardous Materials Laws. Tenant shall indemnify, defend upon demand with counsel reasonably acceptable to Landlord, and hold harmless Landlord from and against any liabilities, losses, claims, damages, lost profits, consequential damages, interest, penalties, fines, monetary sanctions, attorneys' fees, experts' fees, court costs, remediation costs, investigation costs, and other expenses which result from or arise in any manner whatsoever out of the use, storage, treatment, transportation, release, or disposal of Hazardous Materials on or about the Project by Tenant or Tenant's Agents after the Effective Date.

B. If the presence of Hazardous Materials on the Project caused or permitted by Tenant or Tenant's Agents after the Effective Date results in contamination or deterioration of water or soil resulting in a level of contamination greater than the levels established as acceptable by any governmental agency having jurisdiction over such contamination, then Tenant shall promptly take any and all action necessary to investigate and remediate such contamination if required by Law or as a condition to the issuance or continuing effectiveness of any governmental approval which relates to the use of the Project or any part thereof. Tenant shall further be solely responsible for, and shall defend, indemnify and hold Landlord and its agents harmless from and against, all claims, costs and liabilities, including attorneys' fees and costs, arising out of or in connection with any investigation and remediation required hereunder to return the Project to its condition existing prior to the appearance of such Hazardous Materials.

C. Landlord and Tenant shall each give written notice to the other as soon as reasonably practicable of (i) any communication received from any governmental authority concerning Hazardous Materials which relates to the Project, and (ii) any contamination of the Project by Hazardous Materials which constitutes a violation of any Hazardous Materials Law. Tenant may use small quantities of household chemicals such as adhesives, lubricants, and cleaning fluids in order to conduct its business at the Premises and such other Hazardous Materials as are necessary for the operation of Tenant's business of which Landlord receives notice prior to such Hazardous Materials being brought onto the Premises and which Landlord consents in writing may be brought onto the Premises. At any time during the Lease Term, Tenant shall, within five days after written request therefor received from Landlord, disclose in writing all Hazardous Materials that are being used by Tenant on the Project, the nature of such use, and the manner of storage and disposal.

D. Landlord may cause testing wells to be installed on the Project, and may cause the ground water to be tested to detect the presence of Hazardous Material by the use of such tests as are then customarily used for such purposes. If Tenant so requests, Landlord shall supply Tenant with copies of such test results. The cost of such tests and of the installation, maintenance, repair and replacement of such wells shall be paid by Tenant if such tests disclose the existence of facts which give rise to liability of Tenant pursuant to its indemnity given in ¶7.2A and/or ¶7.2B.

E. As used herein, the term "Hazardous Material," means any hazardous or toxic substance, material or waste which is or becomes regulated by any local governmental authority, the State of California or the United States Government. The term "Hazardous Material," includes, without limitation, petroleum products, asbestos, PCB's, and any material or substance which is (i) listed under Article 9 or defined as hazardous or extremely hazardous pursuant to Article 11 of Title 22 of the California Administrative Code, Division 4, Chapter 20, (ii) defined as a "hazardous waste" pursuant to Section 1004 of the Federal Resource Conservation and Recovery Act, 42 U.S.C. 6901 et seq. (42 U.S.C. 6903), or (iii) defined as a "hazardous substance" pursuant to Section 101 of the Comprehensive Environmental Response; Compensation and Liability Act, 42 U.S.C. 9601 et seq. (42 U.S.C. 9601). As used herein, the term "Hazardous Material Law" shall mean any statute, law, ordinance, or regulation of any governmental body or agency (including the U.S. Environmental Protection Agency, the California Regional Water Quality Control Board, and the California Department of Health Services) which regulates the use, storage, release or disposal of any Hazardous Material.

F. The obligations of Landlord and Tenant under this ¶7.2 shall survive the expiration or earlier termination of the Lease Term. The

rights and obligations of Landlord and Tenant with respect to issues relating to Hazardous Materials are exclusively established by this ¶7.2. In the event of any inconsistency between any other part of this Lease and this ¶7.2, the terms of this ¶7.2 shall control.

7.3 Utilities: Tenant shall promptly pay, as the same become due, all charges for water, gas, electricity, telephone, sewer service, waste pick-up and any other utilities, materials or services furnished directly to or used by Tenant on or about the Premises during the Lease Term, including, without limitation, (i) meter, use and/or connection fees, hook-up fees, or standby fee (excluding any connection fees or hook-up fees which relate to making the existing electrical, gas, and water service available to the Premises as of the Commencement Date), and (ii) penalties for discontinued or interrupted service. If any utility service is not separately metered to the Premises, then Tenant shall pay its pro rata share of the cost of such utility service with all others served by the service not separately metered. However, if Landlord determines that Tenant is using a disproportionate amount of any utility service not separately metered, then Landlord at its election may (i) periodically charge Tenant, as Additional Rent, a sum equal to Landlord's reasonable estimate of the cost of Tenant's excess use of such utility service, or (ii) install a separate meter (at Tenant's expense) to measure the utility service supplied to the Premises.

7.4 Compliance with Governmental Regulations: Landlord and Tenant shall comply with all rules, regulations and requirements promulgated by national, state or local governmental agencies or utility suppliers concerning the use of utility services, including any rationing, limitation or other control. Tenant shall not be entitled to terminate this Lease nor to any abatement in rent by reason of such compliance.

## ARTICLE 8

### COMMON OPERATING EXPENSES

8.1 Tenant's Obligation to Reimburse: As Additional Rent, Tenant shall pay Tenant's Share (specified in Section G of the Summary) of all Common Operating Expenses; provided, however, if the Project contains more than one building, then Tenant shall pay Tenant's Share of all Common Operating Expenses fairly allocable to the Building, including (i) all Common Operating Expenses paid with respect to the maintenance, repair, replacement and use of the Building, and (ii) a proportionate share (based on the Building Gross Leasable Area as a percentage of the Project Gross Leasable Area) of all Common Operating Expenses which relate to the Project in general are not fairly allocable to any one building that is part of the Project. Tenant shall pay such share of the actual Common Operating Expenses incurred or paid by Landlord but not theretofore billed to Tenant within 10 days after receipt of a written bill therefor from Landlord, on such periodic basis as Landlord shall designate, but in no event more frequently than once a month. Alternatively, Landlord may from time to time require that Tenant pay Tenant's Share of Common Operating Expenses in advance in estimated monthly installments, in accordance with the following: (i) Landlord shall deliver to Tenant Landlord's reasonable estimate of the Common Operating expenses it anticipates will be paid or incurred for the Landlord's fiscal year in question; (ii) during such Landlord's fiscal year Tenant shall pay such share of the estimated Common Operating Expenses in advance in monthly installments as required by Landlord due with the installments of Base Monthly Rent; and (iii) within 90 days after the end of each Landlord's fiscal year, Landlord shall furnish to Tenant a statement in reasonable detail of the actual Common Operating Expenses paid or incurred by Landlord during the just ended Landlord's fiscal year and thereupon there shall be an adjustment between Landlord and Tenant, with payment to Landlord or credit by Landlord against the next installment of Base Monthly Rent, as the case may require, within 10 days after delivery by Landlord to Tenant of said statement, so that Landlord shall receive the entire amount of Tenant's Share of all Common Operating Expenses for such Landlord's fiscal year and no more. Tenant shall have the right at its expense, exercisable upon reasonable prior written notice to Landlord, to inspect at Landlord's office during normal business hours Landlord's books and records as they relate to Common Operating Expenses. Such inspection must be within 30 days of Tenant's receipt of Landlord's annual statement for the same, and shall be limited to verification of the charges contained in such statement. Tenant may not withhold payment of such bill pending completion of such inspection.

8.2 Common Operating Expenses Defined: The term "Common Operating Expenses" shall mean the following:

A. All costs and expenses paid or incurred by Landlord in doing the following (including payments to independent contractors providing services related to the performance of the following): (i) maintaining, cleaning, repairing and resurfacing the roof (including repair of leaks) and the exterior surfaces (including painting) of all buildings located on the Project; (ii) maintenance of the liability, fire and property damage insurance covering the Project carried by Landlord pursuant to ¶9.2 (including the prepayment of premiums for coverage of up to one year); (iii) maintaining, repairing, operating and replacing when necessary HVAC equipment, utility facilities and other building service equipment; (iv) providing utilities to the Common Area (including lighting, trash removal and water for landscaping irrigation); (v) complying with all applicable Laws and Private Restrictions; (vi) operating, maintaining, repairing, cleaning, painting, restriping and resurfacing the Common Area; (vii) replacement or installation of lighting fixtures, directional or other signs and signals, irrigation systems, trees, shrubs, ground cover and other plant materials, and all landscaping in the Common Area; and (viii) providing security;

B. The following costs: (i) Real Property Taxes as defined in ¶8.3; (ii) the amount of any "deductible" paid by Landlord with respect to damage caused by any Insured Peril; (iii) the cost to repair damage caused by an Uninsured Peril up to a maximum amount in any 12 month period equal to 2% of the replacement cost of the buildings or other improvements damaged; and (iv) that portion of all compensation (including benefits and premiums for workers' compensation and other insurance) paid to or on behalf of employees of Landlord but only to the extent they are involved in the performance of the work described by ¶8.2A that is fairly allocable to the Project;

C. Fees for management services rendered by either Landlord or a third party manager engaged by Landlord (which may be a party affiliated with Landlord), except that the total amount charged for management services and included in Tenant's Share of Common Operating Expenses shall not exceed the monthly rate of 5% of the Base Monthly Rent.

D. All additional costs and expenses incurred by Landlord with respect to the operation, protection, maintenance, repair and replacement of the Project which would be considered a current expense (and not a capital expenditure) pursuant to generally accepted accounting principles; provided, however, that Common Operating Expenses shall not include any of the following: (i) payments on any loans or ground leases affecting the Project; (ii) depreciation of any buildings or any major systems of building service equipment within the Project; (iii) leasing commissions; (iv) the cost of tenant improvements installed for the exclusive use of other tenants of the Project; (v)

any cost incurred in complying with Hazardous Materials Laws, which subject is governed exclusively by ¶7.2; and (vi) cost relating to other damages exclusively deemed to have been caused by other Tenants in the Project.

8.3 Real Property Taxes Defined: The term “Real Property Taxes” shall mean all taxes, assessments, levies, and other charges of any kind or nature whatsoever, general and special, foreseen and unforeseen (including all installments of principal and interest required to pay any existing or future general or special assessments for public improvements, services or benefits, and any increases resulting from reassessments resulting from a change in ownership, new construction, or any other cause), now or hereafter imposed by any governmental or quasi-governmental authority or special district having the direct or indirect power to tax or levy assessments, which are levied or assessed against, or with respect to the value, occupancy or use of all or any portion of the Project (as now constructed or as may at any time hereafter be constructed, altered, or otherwise changed) or Landlord’s interest therein, the fixtures, equipment and other property of Landlord, real or personal, that are an integral part of and located on the Project, the gross receipts, income, or rentals from the Project, or the use of parking areas, public utilities, or energy within the Project, or Landlord’s business of leasing the Project. If at any time during the Lease Term the method of taxation or assessment of the Project prevailing as of the Effective Date shall be altered so that in lieu of or in addition to any Real Property Tax described above there shall be levied, assessed or imposed (whether by reason of a change in the method of taxation or assessment, creation of a new tax or charge, or any other cause) an alternate or additional tax or charge (i) on the value, use or occupancy of the Project or Landlord’s interest therein, or (ii) on or measured by the gross receipts, income or rentals from the Project, on Landlord’s business of leasing the Project, or computed in any manner with respect to the operation of the Project, then any such tax or charge, however designated, shall be included within the meaning of the term “Real Property Taxes” for purposes of this Lease. If any Real Property Tax is based upon property or rents unrelated to the Project, then only that part of such Real Property Tax that is fairly allocable to the Project shall be included within the meaning of the term “Real Property Taxes”. Notwithstanding the foregoing, the term “Real Property Taxes” shall not include estate, inheritance, transfer, gift or franchise taxes of Landlord or the federal or state net income tax imposed on Landlord’s income from all sources.

## ARTICLE 9

### INSURANCE

9.1 Tenant's Insurance: Tenant shall maintain insurance complying with all of the following:

A. Tenant shall procure, pay for and keep in full force and effect the following:

- (1). Commercial general liability insurance, including property damage, against liability for personal injury, bodily injury, death and damage to property occurring in or about, or resulting from an occurrence in or about, the Premises with combined single limit coverage of not less than the amount of Tenant’s Liability Insurance Minimum specified in Section P of the Summary, which insurance shall contain a “contractual liability” endorsement insuring Tenant’s performance of Tenant’s obligation to indemnify Landlord contained in ¶10.3;
- (2). Fire and property damage insurance in so-called “all risk” form insuring Tenant’s Trade Fixtures and Tenant’s Alterations for the full actual replacement cost thereof;
- (3). Such other insurance that is either (i) required by any Lender, or (ii) reasonably required by Landlord and customarily carried by tenants of similar property in similar businesses.

B. Where applicable and required by Landlord, each policy of insurance required to be carried by Tenant pursuant to this ¶9.1: (i) shall name Landlord and such other parties in interest as Landlord reasonably designates as additional insured; (ii) shall be primary insurance which provides that the insurer shall be liable for the full amount of the loss up to and including the total amount of liability set forth in the declarations without the right of contribution from any other insurance coverage of Landlord; (iii) shall be in a form satisfactory to Landlord; (iv) shall be carried with companies reasonably acceptable to Landlord; (v) shall provide that such policy shall not be subject to cancellation, lapse or change except after at least 30 days prior written notice to Landlord so long as such provision of 30 days notice is reasonably obtainable, but in any event not less than 10 days prior written notice; (vi) shall not have a “deductible” in excess of such amount as is approved by Landlord; (vii) shall contain a cross liability endorsement; and (viii) shall contain a “severability” clause. If Tenant has in full force and effect a blanket policy of liability insurance with the same coverage for the Premises as described above, as well as other coverage of other premises and properties of Tenant, or in which Tenant has some interest, such blanket insurance shall satisfy the requirements of this ¶9.1.

C. A copy of each paid-up policy evidencing the insurance required to be carried by Tenant pursuant to this ¶9.1 (appropriately authenticated by the insurer) or a certificate of the insurer, certifying that such policy has been issued, providing the coverage required by this ¶9.1, and containing the provisions specified herein, shall be delivered to Landlord prior to the time Tenant or any of its Agents enters the Premises and upon renewal of such policies, but not less than 5 days prior to the expiration of the term of such coverage. Landlord may, at any time, and from time to time, inspect and/or copy any and all insurance policies required to be procured by Tenant pursuant to this ¶9.1. If any Lender or insurance advisor reasonably determines at any time that the amount of coverage required for any policy of insurance Tenant is to obtain pursuant to this ¶9.1 is not adequate, then Tenant shall increase such coverage for such insurance to such amount as such Lender or insurance advisor reasonably deems adequate, not to exceed the level of coverage for such insurance commonly carried by comparable businesses similarly situated.

9.2 Landlord's Insurance: Landlord shall have the following obligations and options regarding insurance:

A. Landlord shall maintain a policy or policies of fire and property damage insurance in so-called “all risk” form insuring Landlord (and such others as Landlord may designate) against loss of rents for a period of not less than 12 months and from physical damage to the Project with coverage of not less than the full replacement cost thereof. Landlord may so insure the Project separately, or may insure the Project with other property owned by Landlord which Landlord elects to insure together under the same policy or policies. Such fire and property damage insurance (i) may be endorsed to cover loss caused by such additional perils against which Landlord may elect to insure, including earthquake and/or flood, and to provide such additional coverage as Landlord reasonably requires, and (ii) shall contain reasonable “deductibles” which, in the case of earthquake and flood insurance, may be up to 15% of the replacement value of the property

insured or such higher amount as is then commercially reasonable. Landlord shall not be required to cause such insurance to cover any Trade Fixtures or Tenant's Alterations of Tenant.

B. Landlord may maintain a policy or policies of commercial general liability insurance insuring Landlord (and such others as are designated by Landlord) against liability for personal injury, bodily injury, death and damage to property occurring or resulting from an occurrence in, on or about the Project, with combined single limit coverage in such amount as Landlord from time to time determines is reasonably necessary for its protection.

9.3 Tenant's Obligation to Reimburse: If Landlord's insurance rates for the Building are increased at any time during the Lease Term as a result of the nature of Tenant's use of the Premises, Tenant shall reimburse Landlord for the full amount of such increase immediately upon receipt of a bill from Landlord therefor.

9.4 Release and Waiver of Subrogation: The parties hereto release each other, and their respective agents and employees, from any liability for injury to any person or damage to property that is caused by or results from any risk insured against under any valid and collectible insurance policy carried by either of the parties which contains a waiver of subrogation by the insurer and is in force at the time of such injury or damage; subject to the following limitations: (i) the foregoing provision shall not apply to the commercial general liability insurance described by subparagraphs ¶9.1A and ¶9.2B; (ii) such release shall apply to liability resulting from any risk insured against or covered by self-insurance maintained or provided by Tenant to satisfy the requirements of ¶9.1 to the extent permitted by this Lease; and (iii) Tenant shall not be released from any such liability to the extent any damages resulting from such injury or damage are not covered by the recovery obtained by Landlord from such insurance, but only if the insurance in question permits such partial release in connection with obtaining a waiver of subrogation from the insurer. This release shall be in effect only so long as the applicable insurance policy contains a clause to the effect that this release shall not affect the right of the insured to recover under such policy. Each party shall use reasonable efforts to cause each insurance policy obtained by it to provide that the insurer waives all right of recovery by way of subrogation against the other party and its agents and employees in connection with any injury or damage covered by such policy. However, if any insurance policy cannot be obtained with such a waiver of subrogation, or if such waiver of subrogation is only available at additional cost and the party for whose benefit the waiver is to be obtained does not pay such additional cost, then the party obtaining such insurance shall notify the other party of that fact and thereupon shall be relieved of the obligation to obtain such waiver of subrogation rights from the insurer with respect to the particular insurance involved.

## ARTICLE 10

### LIMITATION ON LANDLORD'S LIABILITY AND INDEMNITY

10.1 Limitation on Landlord's Liability: Landlord shall not be liable to Tenant, nor shall Tenant be entitled to terminate this Lease or to any abatement of rent (except as expressly provided otherwise herein), for any injury to Tenant or Tenant's Agents, damage to the property of Tenant or Tenant's Agents, or loss to Tenant's business resulting from any cause, including without limitation any: (i) failure, interruption or installation of any HVAC or other utility system or service; (ii) failure to furnish or delay in furnishing any utilities or services when such failure or delay is caused by fire or other peril, the elements, labor disturbances of any character, or any other accidents or other conditions beyond the reasonable control of Landlord; (iii) limitation, curtailment, rationing or restriction on the use of water or electricity, gas or any other form of energy or any services or utility serving the Project; (iv) vandalism or forcible entry by unauthorized persons or the criminal act of any person; or (v) penetration of water into or onto any portion of the Premises or the Building through roof leaks or otherwise. Notwithstanding the foregoing but subject to ¶9.4, Landlord shall be liable for any such injury, damage or loss which is proximately caused by Landlord's willful misconduct or negligence of which Landlord has actual notice and a reasonable opportunity to cure but which it fails to so cure.

10.2 Limitation on Tenant's Recourse: If Landlord is a corporation, trust, partnership, joint venture, unincorporated association or other form of business entity: (i) the obligations of Landlord shall not constitute personal obligations of the officers, directors, trustees, partners, joint venturers, members, owners, stockholders, or other principals or representatives of such business entity; and (ii) Tenant shall not have recourse to the assets of such officers, directors, trustees, partners, joint venturers, members, owners, stockholders, principals or representatives except to the extent of their interest in the Project. Tenant shall have recourse only to the interest of Landlord in the Project for the satisfaction of the obligations of Landlord and shall not have recourse to any other assets of Landlord for the satisfaction of such obligations.

10.3 Indemnification of Landlord: Tenant shall hold harmless, indemnify and defend Landlord, and its employees, agents and contractors, with competent counsel reasonably satisfactory to Landlord (and Landlord agrees to accept counsel that any insurer requires be used), from all liability, penalties, losses, damages, costs, expenses, causes of action, claims and/or judgments arising by reason of any death, bodily injury, personal injury or property damage resulting from (i) any cause or causes whatsoever (other than the willful misconduct or gross negligence of Landlord of which Landlord has had notice and a reasonable time to cure, but which Landlord has failed to cure) occurring in or about or resulting from an occurrence in or about the Premises during the Lease Term; (ii) the negligence or willful misconduct of Tenant or its agents, employees and contractors, wherever the same may occur; or (iii) an Event of Tenant's Default. The provisions of this ¶10.3 shall survive the expiration or sooner termination of this Lease.

## ARTICLE 11

### DAMAGE TO PREMISES

11.1 Landlord's Duty to Restore: If the Premises are damaged by any peril after the Effective Date, Landlord shall restore the Premises unless the Lease is terminated by Landlord pursuant to ¶11.2 or by Tenant pursuant to ¶11.3. All insurance proceeds available from the fire and property damage insurance carried by Landlord pursuant to ¶9.2 shall be paid to and become the property of Landlord. If this Lease is terminated pursuant to either ¶11.2 or ¶11.3, then all insurance proceeds available from insurance carried by Tenant which covers loss to property that is Landlord's property or would become Landlord's property on termination of this Lease shall be paid to and become the property of Landlord. If this Lease is not so terminated, then upon receipt of the insurance proceeds (if the loss is covered by

insurance) and the issuance of all necessary governmental permits, Landlord shall commence and diligently prosecute to completion the restoration of the Premises, to the extent then allowed by Law, to substantially the same condition in which the Premises were immediately prior to such damage. Landlord's obligation to restore shall be limited to the Premises and interior improvements constructed by Landlord as they existed as of the Commencement Date, excluding any Tenant's Alterations, Trade Fixtures and/or personal property constructed or installed by Tenant in the Premises. Tenant shall forthwith replace or fully repair all Tenant's Alterations and Trade Fixtures installed by Tenant and existing at the time of such damage or destruction, **unless otherwise agreed in writing between Tenant and Landlord**, and all insurance proceeds received by Tenant from the insurance carried by it pursuant to ¶9.1A(2) shall be used for such purpose.

11.2 **Landlord's Right to Terminate:** Landlord shall have the right to terminate this Lease in the event any of the following occurs, which right may be exercised only by delivery to Tenant of a written notice of election to terminate within 30 days after the date of such damage:

A. Either the Project or the Building is damaged by an Insured Peril to such an extent that the estimated cost to restore exceeds 33% of the then actual replacement cost thereof;

B. Either the Project or the Building is damaged by an Uninsured Peril to such an extent that the estimated cost to restore exceeds 2% of the then actual replacement cost thereof; provided, however, that Landlord may not terminate this Lease pursuant to this ¶11.2B if one or more tenants of the Project agree in writing to pay the amount by which the cost to restore the damage exceeds such amount and subsequently deposit such amount with Landlord within 30 days after Landlord has notified Tenant of its election to terminate this Lease;

C. The Premises are damaged by any peril within 12 months of the last day of the Lease Term to such an extent that the estimated cost to restore equals or exceeds an amount equal to six times the Base Monthly Rent then due; provided, however, that Landlord may not terminate this Lease pursuant to this ¶11.2C if Tenant, at the time of such damage, has a then valid express written option to extend the Lease Term and Tenant exercises such option to extend the Lease Term within 15 days following the date of such damage; or

D. Either the Project or the Building is damaged by any peril and, because of the Laws then in force, (i) cannot be restored at reasonable cost to substantially the same condition in which it was prior to such damage, or (ii) cannot be used for the same use being made thereof before such damage if restored as required by this Article.

E. As used herein, the following terms shall have the following meanings: (i) the term "Insured Peril" shall mean a peril actually insured against for which the insurance proceeds actually received by Landlord are sufficient (except for any "deductible" amount specified by such insurance) to restore the Project under then existing building codes to the condition existing immediately prior to the damage; and (ii) the term "Uninsured Peril" shall mean any peril which is not an Insured Peril. Notwithstanding the foregoing, if the "deductible" for earthquake or flood insurance exceeds 2% of the replacement cost of the improvements insured, such peril shall be deemed an "Uninsured Peril".

11.3 **Tenant's Right to Terminate:** If the Premises are damaged by any peril and Landlord does not elect to terminate this Lease or is not entitled to terminate this Lease pursuant to ¶11.2, then as soon as reasonably practicable, Landlord shall furnish Tenant with the written opinion of Landlord's architect or construction consultant as to when the restoration work required of Landlord may be completed. Tenant shall have the right to terminate this Lease in the event any of the following occurs, which right may be exercised only by delivery to Landlord of a written notice of election to terminate within 7 days after Tenant receives from Landlord the estimate of the time needed to complete such restoration.

A. The Premises are damaged by any peril and, in the reasonable opinion of Landlord's architect or construction consultant, the restoration of the Premises cannot be substantially completed within **230** days after the date of such damage; or

B. The Premises are damaged by any peril within 12 months of the last day of the Lease Term and, in the reasonable opinion of Landlord's architect or construction consultant, the restoration of the Premises cannot be substantially completed within 90 days after the date of such damage and such damage renders unusable more than 30% of the Premises.

11.4 **Abatement of Rent:** In the event of damage to the Premises which does not result in the termination of this Lease, the Base Monthly Rent and the Additional Rent shall be temporarily abated during the period of restoration in proportion to the degree to which Tenant's use of the Premises is impaired by such damage **starting with the date of such damage**. Tenant shall not be entitled to any compensation or damages from Landlord for loss of Tenant's business or property or for any inconvenience or annoyance caused by such damage or restoration. Tenant hereby waives the provisions of California Civil Code Sections 1932(2) and 1933(4) and the provisions of any similar law hereinafter enacted.

## ARTICLE 12

### CONDEMNATION

12.1 **Landlord's Termination Right:** Landlord shall have the right to terminate this Lease if, as a result of a taking by means of the exercise of the power of eminent domain (including a voluntary sale or transfer by Landlord to a condemnor under threat of condemnation), (i) all or any part of the Premises is so taken, (ii) more than 10% of the Building Leasable Area is so taken, or (iii) more than 50% of the Common Area is so taken. Any such right to terminate by Landlord must be exercised within a reasonable period of time, to be effective as of the date possession is taken by the condemnor.

12.2 **Tenant's Termination Right:** Tenant shall have the right to terminate this Lease if, as a result of any taking by means of the exercise of the power of eminent domain (including any voluntary sale or transfer by Landlord to any condemnor under threat of condemnation), (i) 10% or more of the Premises is so taken and that part of the Premises that remains cannot be restored within a reasonable period of time and thereby made reasonably suitable for the continued operation of the Tenant's business, or (ii) there is a taking affecting the Common Area and, as a result of such taking, Landlord cannot provide parking spaces within reasonable walking distance of the Premises equal in number to at least 80% of the number of spaces allocated to Tenant by ¶2.1, whether by rearrangement of the



remaining parking areas in the Common Area (including construction of multi-deck parking structures or restriping for compact cars where permitted by Law) or by alternative parking facilities on other land. Tenant must exercise such right within a reasonable period of time, to be effective on the date that possession of that portion of the Premises or Common Area that is condemned is taken by the condemnor.

**12.3 Restoration and Abatement of Rent:** If any part of the Premises or the Common Area is taken by condemnation and this Lease is not terminated, then Landlord shall restore the remaining portion of the Premises and Common Area and interior improvements constructed by Landlord as they existed as of the Commencement Date, excluding any Tenant's Alterations, Trade Fixtures and/or personal property constructed or installed by Tenant. Thereafter, except in the case of a temporary taking, as of the date possession is taken the Base Monthly Rent shall be reduced in the same proportion that the floor area of that part of the Premises so taken (less any addition thereto by reason of any reconstruction) bears to the original floor area of the Premises.

**12.4 Temporary Taking:** If any portion of the Premises is temporarily taken for **six months** or less, this Lease shall remain in effect. If any portion of the Premises is temporarily taken by condemnation for a period which exceeds **six months** or which extends beyond the natural expiration of the Lease Term, and such taking **prevents** Tenant's ability to use the Premises for the Permitted Use, then Tenant shall have the right to terminate this Lease, effective on the date possession is taken by the condemnor.

**12.5 Division of Condemnation Award:** Any award made as a result of any condemnation of the Premises or the Common Area shall belong to and be paid to Landlord, and Tenant hereby assigns to Landlord all of its right, title and interest in any such award; provided, however, that Tenant shall be entitled to receive any condemnation award that is made directly to Tenant for the following so long as the award made to Landlord is not thereby reduced: (i) for the taking of personal property or Trade Fixtures belonging to Tenant; (ii) for the interruption of Tenant's business or its moving costs; (iii) for loss of Tenant's goodwill; or (iv) for any temporary taking where this Lease is not terminated as a result of such taking. The rights of Landlord and Tenant regarding any condemnation shall be determined as provided in this Article, and each party hereby waives the provisions of California Code of Civil Procedure Section 1265.130 and the provisions of any similar law hereinafter enacted allowing either party to petition the Superior Court to terminate this Lease in the event of a partial taking of the Premises.

## ARTICLE 13

### DEFAULT AND REMEDIES

**13.1 Events of Tenant's Default:** Tenant shall be in default of its obligations under this Lease if any of the following events occurs (an "Event of Tenant's Default"):

- A. Tenant shall have failed to pay Base Monthly Rent or Additional Rent when due, and such failure is not cured within 3 days after delivery of written notice from Landlord specifying such failure to pay; or
- B. Tenant shall have failed to perform any term, covenant, or condition of this Lease except those requiring the payment of Base Monthly Rent or Additional Rent, and Tenant shall have failed to cure such breach within 30 days after written notice from Landlord specifying the nature of such breach where such breach could reasonably be cured within said 30 day period, or if such breach could not be reasonably cured within said 30 day period, Tenant shall have failed to commence such cure within said 30 day period and thereafter continue with due diligence to prosecute such cure to completion within such time period as is reasonably needed but not to exceed 90 days from the date of Landlord's notice; or
- C. Tenant shall have sublet the Premises or assigned its interest in the Lease in violation of the provisions contained in Article 14; or
- D. Tenant shall have abandoned the Premises or left the Premises substantially vacant; or
- E. The occurrence of the following: (i) the making by Tenant of any general arrangements or assignments for the benefit of creditors; (ii) Tenant becomes a "debtor" as defined in 11 USC §101 or any successor statute thereto (unless, in the case of a petition filed against Tenant, the same is dismissed within 60 days); (iii) the appointment of a trustee or receiver to take possession of substantially all of Tenant's assets located at the Premises or of Tenant's interest in this Lease, where possession is not restored to Tenant within 30 days; or (iv) the attachment, execution or other judicial seizure of substantially all of Tenant's assets located at the Premises or of Tenant's interest in this Lease, where such seizure is not discharged within 30 days; provided, however, in the event that any provision of this Section 13.1E is contrary to any applicable Law, such provision shall be of no force or effect; or
- F. Tenant shall have failed to deliver documents required of it pursuant to ¶15.4 or ¶15.6 within the time periods specified therein.

**13.2 Landlord's Remedies:** If an Event of Tenant's Default occurs, Landlord shall have the following remedies, in addition to all other rights and remedies provided by any Law or otherwise provided in this Lease, to which Landlord may resort cumulatively or in the alternative:

- A. Landlord may keep this Lease in effect and enforce by an action at law or in equity all of its rights and remedies under this Lease, including (i) the right to recover the rent and other sums as they become due by appropriate legal action; (ii) the right to make payments required of Tenant or perform Tenant's obligations and be reimbursed by Tenant for the cost thereof with interest at the Agreed Interest Rate from the date the sum is paid by Landlord until Landlord is reimbursed by Tenant; and (iii) the remedies of injunctive relief and specific performance to compel Tenant to perform its obligations under this Lease. Notwithstanding anything contained in this Lease, in the event of a breach of an obligation by Tenant which results in a condition which poses an imminent danger to safety of persons or damage to property, an unsightly condition visible from the exterior of the Building, or a threat to insurance coverage, then if Tenant does not cure such breach within 3 days after delivery to it of written notice from Landlord identifying the breach, Landlord may cure the breach of Tenant and be reimbursed by Tenant for the cost thereof with interest at the Agreed Interest Rate from the date the sum is paid by Landlord until Landlord is reimbursed by Tenant.
- B. Landlord may enter the Premises and release them to third parties for Tenant's account for any period, whether shorter or longer

than the remaining Lease Term. Tenant shall be liable immediately to Landlord for all costs Landlord incurs in releasing the Premises, including brokers' commissions, expenses of altering and preparing the Premises required by the releasing. Tenant shall pay to Landlord the rent and other sums due under this Lease on the date the rent is due, less the rent and other sums Landlord received from any releasing. No act by Landlord allowed by this subparagraph shall terminate this Lease unless Landlord notifies Tenant in writing that Landlord elects to terminate this Lease. Notwithstanding any releasing without termination, Landlord may later elect to terminate this Lease because of the default by Tenant.

C. Landlord may terminate this Lease by giving Tenant written notice of termination, in which event this Lease shall terminate on the date set forth for termination in such notice. Any termination under this ¶13.2C shall not relieve Tenant from its obligation to pay sums then due Landlord or from any claim against Tenant for damages or rent previously accrued or then accruing. In no event shall any one or more of the following actions by Landlord, in the absence of a written election by Landlord to terminate this Lease, constitute a termination of this Lease: (i) appointment of a receiver or keeper in order to protect Landlord's interest hereunder; (ii) consent to any subletting of the Premises or assignment of this Lease by Tenant, whether pursuant to the provisions hereof or otherwise; or (iii) any other action by Landlord or Landlord's Agents intended to mitigate the adverse effects of any breach of this Lease by Tenant, including without limitation any action taken to maintain and preserve the Premises or any action taken to relet the Premises or any portions thereof to the extent such actions do not affect a termination of Tenant's right to possession of the Premises.

D. In the event Tenant breaches this Lease and abandons the Premises, this Lease shall not terminate unless Landlord gives Tenant written notice of its election to so terminate this Lease. No act by or on behalf of Landlord intended to mitigate the adverse effect of such breach, including those described by ¶13.C, shall constitute a termination of Tenant's right to possession unless Landlord gives Tenant written notice of termination. Should Landlord not terminate this Lease by giving Tenant written notice, Landlord may enforce all its rights and remedies under this Lease, including the right to recover the rent as it becomes due under the Lease as provided in California Civil Code Section 1951.4.

E. In the event Landlord terminates this Lease, Landlord shall be entitled, at Landlord's election, to damages in an amount as set forth in California Civil Code Section 1951.2 as in effect on the Effective Date. For purposes of computing damages pursuant to California Civil Code Section 1951.2, (i) an interest rate equal to the Agreed Interest Rate shall be used where permitted, and (ii) the term "rent" includes Base Monthly Rent and Additional Rent. Such damages shall include:

(1). The worth at the time of award of the amount by which the unpaid rent for the balance of the term after the time of award exceeds the amount of such rental loss that Tenant proves could be reasonably avoided, computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of award plus one percent (1%); and

(2). Any other amount necessary to compensate Landlord for all detriment proximately caused by Tenant's failure to perform Tenant's obligations under this Lease, or which in the ordinary course of things would be likely to result therefrom, including the following: (i) expenses for cleaning, repairing or restoring the Premises; (ii) expenses for altering, remodeling or otherwise improving the Premises for the purpose of reletting, including installation of leasehold improvements (whether such installation be funded by a reduction of rent, direct payment or allowance to a new tenant, or otherwise); (iii) broker's fees, advertising costs and other expenses of reletting the Premises; (iv) costs of carrying the Premises, such as taxes, insurance premiums, utilities and security precautions; (v) expenses in retaking possession of the Premises; and (vi) attorneys' fees and court costs incurred by Landlord in retaking possession of the Premises and in releasing the Premises or otherwise incurred as a result of Tenant's default.

F. Nothing in this ¶13.2 shall limit Landlord's right to indemnification from Tenant as provided in ¶7.2 and ¶10.3. Any notice given by Landlord in order to satisfy the requirements of ¶13.1A or ¶13.1B above shall also satisfy the notice requirements of California Code of Civil Procedure Section 1161 regarding unlawful detainer proceedings.

13.3 Waiver: One party's consent to or approval of any act by the other party requiring the first party's consent or approval shall not be deemed to waive or render unnecessary the first party's consent to or approval of any subsequent similar act by the other party. The receipt by Landlord of any rent or payment with or without knowledge of the breach of any other provision hereof shall not be deemed a waiver of any such breach unless such waiver is in writing and signed by Landlord. No delay or omission in the exercise of any right or remedy accruing to either party upon any breach by the other party under this Lease shall impair such right or remedy or be construed as a waiver of any such breach theretofore or thereafter occurring. The waiver by either party of any breach of any provision of this Lease shall not be deemed to be a waiver of any subsequent breach of the same or of any other provisions herein contained.

13.4 Limitation On Exercise of Rights: At any time that an Event of Tenant's Default has occurred and remains uncured, (i) it shall not be unreasonable for Landlord to deny or withhold any consent or approval requested of it by Tenant which Landlord would otherwise be obligated to give, and (ii) Tenant may not exercise any option to extend, right to terminate this Lease, or other right granted to it by this Lease which would otherwise be available to it.

13.5 Waiver by Tenant of Certain Remedies: Tenant waives the provisions of Sections 1932(1), 1941 and 1942 of the California Civil Code and any similar or successor law regarding Tenant's right to terminate this Lease or to make repairs and deduct the expenses of such repairs from the rent due under this Lease. Tenant hereby waives any right of redemption or relief from forfeiture under the laws of the State of California, or under any other present or future law, including the provisions of Sections 1174 and 1179 of the California Code of Civil Procedure.

## ARTICLE 14

### ASSIGNMENT AND SUBLETTING

14.1 Transfer By Tenant: The following provisions shall apply to any assignment, subletting or other transfer by Tenant or any subtenant or assignee or other successor in interest of the original Tenant (collectively referred to in this ¶14.1 as "Tenant"):

A. Tenant shall not do any of the following (collectively referred to herein as a "Transfer"), whether voluntarily, involuntarily or by

operation of law, without the prior written consent of Landlord, which consent shall not be unreasonably withheld or delayed: (i) sublet all or any part of the Premises or allow it to be sublet, occupied or used by any person or entity other than Tenant; (ii) assign its interest in this Lease; (iii) mortgage or encumber the Lease (or otherwise use the Lease as a security device) in any manner; or (iv) materially amend or modify an assignment, sublease or other transfer that has been previously approved by Landlord. Tenant shall reimburse Landlord for all reasonable costs and attorneys' fees incurred by Landlord in connection with the evaluation, processing, and/or documentation of any requested Transfer, whether or not Landlord's consent is granted. Landlord's reasonable costs shall include the cost of any review or investigation performed by Landlord or consultant acting on Landlord's behalf of (i) Hazardous Materials (as defined in Section 7.2E of this Lease) used, stored, released, or disposed of by the potential Subtenant or Assignee, and/or (ii) violations of Hazardous Materials Law (as defined in Section 7.2E of this lease) by the Tenant or the proposed Subtenant or Assignee. Any Transfer so approved by Landlord shall not be effective until Tenant has delivered to Landlord an executed counterpart of the document evidencing the Transfer which (i) is in a form reasonably approved by Landlord; (ii) contains the same terms and conditions as stated in Tenant's notice given to Landlord pursuant to ¶14.1B; and (iii) in the case of an assignment of the Lease, contains the agreement of the proposed transferee to assume all obligations of Tenant under this Lease arising after the effective date of such Transfer and to remain jointly and severally liable therefor with Tenant. Any attempted Transfer without Landlord's consent shall constitute an Event of Tenant's Default and shall be voidable at Landlord's option. Landlord's consent to any one Transfer shall not constitute a waiver of the provisions of this ¶14.1 as to any subsequent Transfer or a consent to any subsequent Transfer. No Transfer, even with the consent of Landlord, shall relieve Tenant of its personal and primary obligation to pay the rent and to perform all of the other obligations to be performed by Tenant hereunder. The acceptance of rent by Landlord from any person shall not be deemed to be a waiver by Landlord of any provision of this Lease nor to be a consent to any Transfer.

B. At least 30 days before a proposed Transfer is to become effective, Tenant shall give Landlord written notice of the proposed terms of such Transfer and request Landlord's approval, which notice shall include the following: (i) the name and legal composition of the proposed transferee; (ii) a current financial statement of the transferee, financial statements of the transferee covering the preceding three years if the same exist, and (if available) an audited financial statement of the transferee for a period ending not more than one year prior to the proposed effective date of the Transfer, all of which statements are prepared in accordance with generally accepted accounting principles; (iii) the nature of the proposed transferee's business to be carried on in the Premises; (iv) all consideration to be given on account of the Transfer; (v) a current financial statement of Tenant; and (vi) an accurately filled out response to Landlord's standard Hazardous Materials Questionnaire. Tenant shall provide to Landlord such other information as may be reasonably requested by Landlord within seven days after Landlord's receipt of such notice from Tenant. Landlord shall respond in writing to Tenant's request for Landlord's consent to a Transfer within the later of (i) 15 days of receipt of such request together with the required accompanying documentation, or (ii) seven days after Landlord's receipt of all information which Landlord reasonably requests within seven days after it receives Tenant's first notice regarding the Transfer in question. If Landlord fails to respond in writing within said period, Landlord will be deemed to have withheld consent to such Transfer. Tenant shall immediately notify Landlord of any material modification to the proposed terms of such Transfer.

C. In the event that Tenant seeks to make any Transfer, Landlord shall have the right to terminate this Lease or, in the case of a sublease of less than all of the Premises, terminate this Lease as to that part of the Premises proposed to be so sublet, either (i) on the condition that the proposed transferee immediately enter into a direct lease of the Premises with Landlord (or, in the case of a partial sublease, a lease for the portion proposed to be so sublet) on the same terms and conditions contained in Tenant's notice, or (ii) so that Landlord is thereafter free to lease the Premises (or, in the case of a partial sublease, the portion proposed to be so sublet) to whomever it pleases on whatever terms are acceptable to Landlord. In the event Landlord elects to so terminate this Lease, then (i) if such termination is conditioned upon the execution of a lease between Landlord and the proposed transferee, Tenant's obligations under this Lease shall not be terminated until such transferee executes a new lease with Landlord, enters into possession and commences the payment of rent, and (ii) if Landlord elects simply to terminate this Lease (or, in the case of a partial sublease, terminate this Lease as to the portion to be so sublet), the Lease shall so terminate in its entirety (or as to the space to be so sublet) fifteen (15) days after Landlord has notified Tenant in writing of such election. Upon such termination, Tenant shall be released from any further obligation under this Lease if it is terminated in its entirety, or shall be released from any further obligation under the Lease with respect to the space proposed to be sublet in the case of a proposed partial sublease. In the case of a partial termination of the Lease, the Base Monthly Rent and Tenant's Share shall be reduced to an amount which bears the same relationship to the original amount thereof as the area of that part of the Premises which remains subject to the Lease bears to the original area of the Premises. Landlord and Tenant shall execute a cancellation and release with respect to the Lease to effect such termination.

D. If Landlord consents to a Transfer proposed by Tenant, Tenant may enter into such Transfer, and if Tenant does so, the following shall apply:

- (1). Tenant shall not be released of its liability for the performance of all of its obligations under the Lease.
- (2). If Tenant assigns its interest in this Lease, then Tenant shall pay to Landlord 50% of all Subrent (as defined in ¶14.1D(5)) received by Tenant over and above (i) the assignee's agreement to assume the obligations of Tenant under this Lease, and (ii) all Permitted Transfer Costs related to such assignment. In the case of assignment, the amount of Subrent owed to Landlord shall be paid to Landlord on the same basis, whether periodic or in lump sum, that such Subrent is paid to Tenant by the assignee.
- (3). If Tenant sublets any part of the Premises, then with respect to the space so subleased, Tenant shall pay to Landlord 50% of the positive difference, if any, between (i) all Subrent paid by the subtenant to Tenant, less (ii) the sum of all Base Monthly Rent and Additional Rent allocable to the space sublet and all Permitted Transfer Costs related to such sublease. Such amount shall be paid to Landlord on the same basis, whether periodic or in lump sum, that such Subrent is paid to Tenant by its subtenant. In calculating Landlord's share of any periodic payments, all Permitted Transfer Costs shall be first recovered by Tenant.
- (4). Tenant's obligations under this ¶14.1D shall survive any Transfer, and Tenant's failure to perform its obligations hereunder shall be an Event of Tenant's Default. At the time Tenant makes any payment to Landlord required by this ¶14.1D, Tenant shall deliver an itemized statement of the method by which the amount to which Landlord is entitled was calculated, certified by Tenant as true and correct. Landlord shall have the right at reasonable intervals to inspect Tenant's books and records relating to the payments due hereunder. Upon request therefor, Tenant shall deliver to Landlord copies of all bills, invoices or other documents upon which its calculations are based. Landlord may condition its approval of any Transfer upon obtaining a certification from both Tenant and the proposed transferee of all

Subrent and other amounts that are to be paid to Tenant in connection with such Transfer.

(5). As used in this ¶14.1D, the term “Subrent” shall mean any consideration of any kind received, or to be received, by Tenant as a result of the Transfer, if such sums are related to Tenant’s interest in this Lease or in the Premises, including payments from or on behalf of the transferee (in excess of the book value thereof) for Tenant’s assets, fixtures, leasehold improvements, inventory, accounts, goodwill, equipment, furniture, and general intangibles. As used in this ¶14.1D, the term “Permitted Transfer Costs” shall mean (i) all reasonable leasing commissions paid to third parties not affiliated with Tenant in order to obtain the Transfer in question; and (ii) all reasonable attorneys’ fees incurred by Tenant with respect to the Transfer in question.

E. If Tenant is a corporation, the following shall be deemed a voluntary assignment of Tenant’s interest in this Lease: (i) any dissolution, merger, consolidation, or other reorganization of or affecting Tenant, whether or not Tenant is the surviving corporation; and (ii) if the capital stock of Tenant is not publicly traded, the sale or transfer to one person or entity (or to any group of related persons or entities) stock possessing more than 50% of the total combined voting power of all classes of Tenant’s capital stock issued, outstanding and entitled to vote for the election of directors. If Tenant is a partnership, any withdrawal or substitution (whether voluntary, involuntary or by operation of law, and whether occurring at one time or over a period of time) of any partner owning 25% or more (cumulatively) of any interest in the capital or profits of the partnership, or the dissolution of the partnership, shall be deemed a voluntary assignment of Tenant’s interest in this Lease.

F. Notwithstanding anything contained in ¶14.1, so long as Tenant otherwise complies with the provisions of ¶14.1 Tenant may enter into any of the following transfers (a “Permitted Transfer”) without Landlord’s prior written consent, and Landlord shall not be entitled to terminate the Lease pursuant to ¶14.1C or to receive any part of any Subrent resulting therefrom that would otherwise be due it pursuant to ¶14.1D:

(1). Tenant may sublease all or part of the Premises or assign its interest in this Lease to any corporation which controls, is controlled by, or is under common control with the original Tenant to this Lease by means of an ownership interest of more than 50%;

(2). Tenant may assign its interest in the Lease to a corporation which results from a merger, consolidation or other reorganization in which Tenant is not the surviving corporation, so long as the surviving corporation has a net worth at the time of such assignment that is equal to or greater than the net worth of Tenant immediately prior to such transaction; and

(3). Tenant may assign this Lease to a corporation which purchases or otherwise acquires all or substantially all of the assets of Tenant, so long as such acquiring corporation has a net worth at the time of such assignment that is equal to or greater than the net worth of Tenant immediately prior to such transaction.

14.2 Transfer By Landlord: Landlord and its successors in interest shall have the right to transfer their interest in this Lease and the Project at any time and to any person or entity. In the event of any such transfer, the Landlord originally named herein (and, in the case of any subsequent transfer, the transferee) from the date of such transfer, shall be automatically relieved, without any further act by any person or entity, of all liability for the performance of the obligations of the Landlord hereunder which may accrue after the date of such transfer. After the date of any such transfer, the term “Landlord” as used herein shall mean the transferee of such interest in the Premises.

## ARTICLE 15

### GENERAL PROVISIONS

15.1 Landlord’s Right to Enter: Landlord and its agents may enter the Premises at any reasonable time after giving at least 24 hours’ prior notice to Tenant (and immediately in the case of emergency) for the purpose of: (i) inspecting the same; (ii) posting notices of non-responsibility; (iii) supplying any service to be provided by Landlord to Tenant; (iv) showing the Premises to prospective purchasers, mortgagees or tenants; (v) making necessary alterations, additions or repairs; (vi) performing Tenant’s obligations when Tenant has failed to do so after written notice from Landlord; (vii) placing upon the Premises ordinary “for lease” signs or “for sale” signs; and (viii) responding to an emergency. Landlord shall have the right to use any and all means Landlord may deem necessary and proper to enter the Premises in an emergency. Any entry into the Premises obtained by Landlord in accordance with this ¶15.1 shall not be a forcible or unlawful entry into, or a detainer of, the Premises, or an eviction, actual or constructive, of Tenant from the Premises.

15.2 Surrender of the Premises: Upon the expiration or sooner termination of this Lease, Tenant shall vacate and surrender the Premises to Landlord in the same condition as existed at the Commencement Date, except for (i) reasonable wear and tear, (ii) damage caused by any peril or condemnation, and (iii) contamination by Hazardous Materials for which Tenant is not responsible pursuant to ¶7.2A or ¶7.2B. In this regard, normal wear and tear shall be construed to mean wear and tear caused to the Premises by the natural aging process which occurs in spite of prudent application of the **reasonable** standards for maintenance, repair and janitorial practices, and does not include items of neglected or deferred maintenance. In any event, Tenant shall cause the following to be done prior to the expiration or the sooner termination of this Lease: (i) all interior walls shall be painted or cleaned so that they appear freshly painted; (ii) all tiled floors shall be cleaned and waxed; (iii) all carpets shall be cleaned and shampooed; (iv) all broken, marred, stained or nonconforming acoustical ceiling tiles shall be replaced; (v) all windows shall be washed; (vi) the HVAC system shall be serviced by a reputable and licensed service firm and left in good operating condition and repair as so certified by such firm; and (vii) the plumbing and electrical systems and lighting shall be placed in good order and repair (including replacement of any burned out, discolored or broken light bulbs, ballasts, or lenses). If Landlord so requests, Tenant shall, prior to the expiration or sooner termination of this Lease, (i) remove any Tenant’s Alterations which Tenant is required to remove pursuant to ¶5.2 and repair all damage caused by such removal, and (ii) return the Premises or any part thereof to its original configuration existing as of the time the Premises were delivered to Tenant. If the Premises are not so surrendered at the termination of this Lease, Tenant shall be liable to Landlord for all costs incurred by Landlord in returning the Premises to the required condition, plus interest on all costs incurred at the Agreed Interest Rate. Tenant shall indemnify Landlord against loss or liability resulting from delay by Tenant in so surrendering the Premises, including, without limitation, any claims made by any succeeding tenant or losses to Landlord due to lost opportunities to lease to succeeding tenants.

15.3 Holding Over: This Lease shall terminate without further notice at the expiration of the Lease Term. Any holding over by Tenant

after expiration of the Lease Term shall not constitute a renewal or extension of the Lease or give Tenant any rights in or to the Premises except as expressly provided in this Lease. Any holding over after such expiration with the written consent of Landlord shall be construed to be a tenancy from month to month on the same terms and conditions herein specified insofar as applicable except that Base Monthly Rent shall be increased to an amount equal to 150% of the Base Monthly Rent payable during the last full calendar month of the Lease Term.

15.4 Subordination: The following provisions shall govern the relationship of this Lease to any Security Instrument:

A. The Lease is subject and subordinate to all Security Instruments existing as of the Effective Date. However, if any Lender so requires, this Lease shall become prior and superior to any such Security Instrument.

B. At Landlord's election, this Lease shall become subject and subordinate to any Security Instrument created after the Effective Date. Notwithstanding such subordination, Tenant's right to quiet possession of the Premises shall not be disturbed so long as Tenant is not in default and performs all of its obligations under this Lease, unless this Lease is otherwise terminated pursuant to its terms.

C. Tenant shall upon request execute any document or instrument reasonably required by any Lender to make this Lease either prior or subordinate to a Security Instrument, which may include such other matters as the Lender customarily and reasonably requires in connection with such agreements, including provisions that the Lender not be liable for (i) the return of any security deposit unless the Lender receives it from Landlord, and (ii) any defaults on the part of Landlord occurring prior to the time the Lender takes possession of the Project in connection with the enforcement of its Security Instrument. Tenant's failure to execute any such document or instrument within 10 days after written demand therefor shall constitute an Event of Tenant's Default. Tenant approves as reasonable the form of subordination agreement attached to this Lease as Exhibit G.

15.5 Mortgagee Protection and Attornment: In the event of any default on the part of the Landlord, Tenant will use reasonable efforts to give notice by registered mail to any Lender whose name has been provided to Tenant and shall offer such Lender a reasonable opportunity to cure the default, including time to obtain possession of the Premises by power of sale or judicial foreclosure or other appropriate legal proceedings, if such should prove necessary to effect a cure. Tenant shall attorn to any purchaser of the Premises at any foreclosure sale or private sale conducted pursuant to any Security Instrument encumbering the Premises, or to any grantee or transferee designated in any deed given in lieu of foreclosure.

15.6 Estoppel Certificates and Financial Statements: At all times during the Lease Term, each party agrees, following any request by the other party, promptly to execute and deliver to the requesting party within 15 days following delivery of such request an estoppel certificate: (i) certifying that this Lease is unmodified and in full force and effect or, if modified, stating the nature of such modification and certifying that this Lease, as so modified, is in full force and effect, (ii) stating the date to which the rent and other charges are paid in advance, if any, (iii) acknowledging that there are not, to the certifying party's knowledge, any uncured defaults on the part of any party hereunder or, if there are uncured defaults, specifying the nature of such defaults, and (iv) certifying such other information about the Lease as may be reasonably required by the requesting party. A failure to deliver an estoppel certificate within 15 days after delivery of a request therefor shall be a conclusive admission that, as of the date of the request for such statement: (i) this Lease is unmodified except as may be represented by the requesting party in said request and is in full force and effect, (ii) there are no uncured defaults in the requesting party's performance, and (iii) no rent has been paid more than 30 days in advance. At any time during the Lease Term Tenant shall, upon 15 days' prior written notice from Landlord, provide Tenant's most recent financial statement and financial statements covering the 24 month period prior to the date of such most recent financial statement to any existing Lender or to any potential Lender or buyer of the Premises. Such statements shall be prepared in accordance with generally accepted accounting principles and, if such is the normal practice of Tenant, shall be audited by an independent certified public accountant.

15.7 Reasonable Consent: Whenever any party's approval or consent is required by this Lease before an action may be taken by the other party, such approval or consent shall not be unreasonably withheld or delayed.

15.8 Notices: Any notice required or desired to be given regarding this Lease shall be in writing and may be given by personal delivery, by facsimile telecopy, by courier service, or by mail. A notice shall be deemed to have been given (i) on the third business day after mailing if such notice was deposited in the United States mail, certified or registered, postage prepaid, addressed to the party to be served at its Address for Notices specified in Section Q or Section R of the Summary (as applicable), (ii) when delivered if given by personal delivery, and (iii) in all other cases when actually received at the party's Address for Notices. Either party may change its address by giving notice of the same in accordance with this ¶15.8, provided, however, that any address to which notices may be sent must be a California address.

15.9 Attorneys' Fees: In the event either Landlord or Tenant shall bring any action or legal proceeding for an alleged breach of any provision of this Lease, to recover rent, to terminate this Lease or otherwise to enforce, protect or establish any term or covenant of this Lease, the prevailing party shall be entitled to recover as a part of such action or proceeding, or in a separate action brought for that purpose, reasonable attorneys' fees, court costs, and experts' fees as may be fixed by the court.

15.10 Corporate Authority: If Tenant is a corporation (or partnership), each individual executing this Lease on behalf of Tenant represents and warrants that he is duly authorized to execute and deliver this Lease on behalf of such corporation in accordance with the by-laws of such corporation (or partnership in accordance with the partnership agreement of such partnership) and that this Lease is binding upon such corporation (or partnership) in accordance with its terms. Each of the persons executing this Lease on behalf of a corporation does hereby covenant and warrant that the party for whom it is executing this Lease is a duly authorized and existing corporation, that it is qualified to do business in California, and that the corporation has full right and authority to enter into this Lease.

15.11 Miscellaneous: Should any provision of this Lease prove to be invalid or illegal, such invalidity or illegality shall in no way affect, impair or invalidate any other provision hereof, and such remaining provisions shall remain in full force and effect. Time is of the essence with respect to the performance of every provision of this Lease in which time of performance is a factor. The captions used in this Lease are for convenience only and shall not be considered in the construction or interpretation of any provision hereof. Any executed copy of this Lease shall be deemed an original for all purposes. This Lease shall, subject to the provisions regarding assignment, apply to and bind the respective heirs, successors, executors, administrators and assigns of Landlord and Tenant. "Party" shall mean Landlord or Tenant,

as the context implies. If Tenant consists of more than one person or entity, then all members of Tenant shall be jointly and severally liable hereunder. This Lease shall be construed and enforced in accordance with the laws of the State of California. The language in all parts of this Lease shall in all cases be construed as a whole according to its fair meaning, and not strictly for or against either Landlord or Tenant. When the context of this Lease requires, the neuter gender includes the masculine, the feminine, a partnership or corporation or joint venture, and the singular includes the plural. The terms "shall", "will" and "agree" are mandatory. The term "may" is permissive. When a party is required to do something by this Lease, it shall do so at its sole cost and expense without right of reimbursement from the other party unless a provision of this Lease expressly requires reimbursement. Landlord and Tenant agree that (i) the gross leasable area of the Premises includes any atriums, depressed loading docks, covered entrances or egresses, and covered loading areas, (ii) each has had an opportunity to determine to its satisfaction the actual area of the Project and the Premises, (iii) all measurements of area contained in this Lease are conclusively agreed to be correct and binding upon the parties, even if a subsequent measurement of any one of these areas determines that it is more or less than the amount of area reflected in this Lease, and (iv) any such subsequent determination that the area is more or less than shown in this Lease shall not result in a change in any of the computations of rent, improvement allowances, or other matters described in this Lease where area is a factor. Where a party hereto is obligated not to perform any act, such party is also obligated to restrain any others within its control from performing said act, including the Agents of such party. Landlord shall not become or be deemed a partner or a joint venturer with Tenant by reason of the provisions of this Lease.

15.12 Termination by Exercise of Right: If this Lease is terminated pursuant to its terms by the proper exercise of a right to terminate specifically granted to Landlord or Tenant by this Lease, then this Lease shall terminate 30 days after the date the right to terminate is properly exercised (unless another date is specified in that part of the Lease creating the right, in which event the date so specified for termination shall prevail), the rent and all other charges due hereunder shall be prorated as of the date of termination, and neither Landlord nor Tenant shall have any further rights or obligations under this Lease except for those that have accrued prior to the date of termination or those obligations which this Lease specifically provides are to survive termination. This ¶15.12 does not apply to a termination of this Lease by Landlord as a result of an Event of Tenant's Default.

15.13 Brokerage Commissions: Each party hereto (i) represents and warrants to the other that it has not had any dealings with any real estate brokers, leasing agents or salesmen, or incurred any obligations for the payment of real estate brokerage commissions or finder's fees which would be earned or due and payable by reason of the execution of this Lease, other than to the Retained Real Estate Brokers described in Section S of the Summary, and (ii) agrees to indemnify, defend, and hold harmless the other party from any claim for any such commission or fees which result from the actions of the indemnifying party. Landlord shall be responsible for the payment of any commission owed to the Retained Real Estate Brokers if there is a separate written commission agreement between Landlord and the Retained Real Estate Brokers for the payment of a commission as a result of the execution of this Lease.

15.14 Force Majeure: Any prevention, delay or stoppage due to strikes, lock-outs, inclement weather, labor disputes, inability to obtain labor, materials, fuels or reasonable substitutes therefor, governmental restrictions, regulations, controls, action or inaction, civil commotion, fire or other acts of God, and other causes beyond the reasonable control of the party obligated to perform (except financial inability) shall excuse the performance, for a period equal to the period of any said prevention, delay or stoppage, of any obligation hereunder except the obligation of Tenant to pay rent or any other sums due hereunder.

15.15 Entire Agreement: This Lease constitutes the entire agreement between the parties, and there are no binding agreements or representations between the parties except as expressed herein. Tenant acknowledges that neither Landlord nor Landlord's Agents has made any legally binding representation or warranty as to any matter except those expressly set forth herein, including any warranty as to (i) whether the Premises may be used for Tenant's intended use under existing Law, (ii) the suitability of the Premises or the Project for the conduct of Tenant's business, or (iii) the condition of any improvements. There are no oral agreements between Landlord and Tenant affecting this Lease, and this Lease supercedes and cancels any and all previous negotiations, arrangements, brochures, agreements and understandings, if any, between Landlord and Tenant or displayed by Landlord to Tenant with respect to the subject matter of this Lease. This instrument shall not be legally binding until it is executed by both Landlord and Tenant. No subsequent change or addition to this Lease shall be binding unless in writing and signed by Landlord and Tenant.

IN WITNESS WHEREOF, Landlord and Tenant have executed this Lease with the intent to be legally bound thereby, to be effective as of the Effective Date.

LANDLORD:

BRE/PCCP ORCHARD, L.L.C.a  
Delaware limited liability company

By: Orchard 702/703 Investors, LLC  
a Delaware limited liability company, its Member

By: /s/ Michael J. Biggar  
Michael J. Biggar  
Managing Member

Dated: 1/4/06

TENANT:

TEGAL CORPORATION  
a Delaware corporation

By: /s/ Thomas R. Mika  
THOMAS R. MIKA  
[Print Name and Title]

PRESIDENT & CEO

Dated: 12/30/05

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## SUBLEASE AGREEMENT

THIS SUBLEASE AGREEMENT ("Sublease") is made as of this 30th day of December, 2005 by and between SILICON GENESIS CORPORATION, a California corporation ("Sublandlord") and TEGAL CORPORATION., a Delaware corporation ("Subtenant").

### WITNESSETH:

1. Recitals. This Sublease is made with reference to the following facts:
  - 1.1 BRE/PCCP Orchard LLC, a Delaware limited liability company("Master Landlord"), as landlord, and Sublandlord, as tenant, entered into a written lease dated December 22, 2000, a copy of which is attached hereto as Exhibit A("Master Lease") covering the premises commonly known as 51 East Daggett Drive, San Jose, California (being 12,717 rentable square feet and referred to herein as the "Premises") and 61 East Daggett Drive, San Jose, California (being 13,300 rentable square feet).
  - 1.2 The Master Lease was amended on October 1, 2001, December 12, 2001, May 20, 2002 and March 15, 2005. Such amendments are included in the reference to Master Lease.
  - 1.3 Subtenant desires to sublease the Premises from Sublandlord on the terms and conditions contained in this Sublease.
  
2. Basic Sublease Provisions.
  - 2.1 Premises Address: 51 East Daggett Drive, San Jose, California.
  - 2.2 Rentable Area of Premises: Approximately 12,717 square feet of a larger building known as 41-61 East Daggett Drive, San Jose, CA (see exhibit D)
  - 2.3 Subtenant's Percentage Share: 32.35%.
  - 2.4 Commencement Date: February 1, 2006.
  - 2.5 Expiration Date: January 31, 2008.
  - 2.6 Base Monthly Rent: Eleven Thousand Four Hundred Forty-Five Dollars and Thirty Cents (\$11,445.30) per month. Base Monthly Rent shall be paid without demand, deduction, set-off or counter claim, in advance of the first day of each calendar month during the term of this Sublease, and in the event of a partial rental month, rent shall be prorated on the basis of a thirty (30) day month.
  - 2.7 Prepaid Rent: Immediately upon execution of this Sublease, Subtenant shall prepay to Sublandlord the first month's Basic Monthly Rent in the amount of Eleven Thousand Four Hundred Forty-Five Dollars and Thirty Cents (\$11,445.30) per month.
  - 2.8 Rental Adjustment(s) during the sublease term:
 

Adjustment Date	Adjusted Rent
February 1, 2007	\$11,788.66
  - 2.9 Permitted Use: Research and development, storage and distribution, offices, marketing, and other related uses as per the Master Lease.
  - 2.10 Acceptance of Premises: Sublandlord shall deliver the Premises with the roof, HVAC system, electrical, plumbing and lighting in good working condition. Prior to the Commencement Date Sublandlord shall replace all worn ceiling tiles. Otherwise, Subtenant agrees to accept the Premises in an "as is" condition. Subtenant acknowledges that Sublandlord has not made any representation or warranty with respect to this Sublease Agreement, including, without limitation, any representation or warranty as to the suitability of the Premises for the conduct of Subtenant's business, except as specifically set forth in this Sublease. Subtenant shall, at Subtenant's expense, comply promptly with all applicable statutes, ordinances, rules, regulations, orders, restrictions of record and requirements in effect during the term hereof regulating Subtenant's specific use of the Premises, including, without limitation, making structural alterations or providing auxiliary aids and services for Subtenant's specific use of the Premises as required by the Americans with Disabilities Act of 1990, 42 U.S.C. § 12101 etseq. (the "ADA"). In no event shall Subtenant be responsible for the failure of the Premises to



comply currently with any such laws, except to the extent such compliance is triggered by Subtenant's specific use of the Premises.

2.11 Address for payment of rent and notices:

Subtenant:

Tegal Corporation.  
51 East Daggett Drive  
San Jose, California 95134-2109  
Att'n: Thomas Mika  
Phone: 707-765-5630  
Facsimile: 707-763-0436

Sublandlord:

Silicon Genesis Corporation  
1 East Daggett Drive,  
San Jose, California 95134  
Att'n: Ted Fong  
Phone: (408) 288-5858  
Facsimile: (408) 288-5859

Prior to the Commencement Date, however, Subtenant's address shall be  
Tegal Corporation  
2201 S. McDowell Blvd  
Petaluma, CA 94954  
Phone: (707) 763-5600  
FAX: (707) 765-9311

2.12 Security Deposit: Subtenant shall deposit with Master Landlord within two (2) business days after receipt of the Master Landlord's consent to this Sublease Thirty-Five Thousand Dollars and No Cents (\$35,000.00) ("Deposit"), which will be in the form of cash as security for Subtenant's faithful performance of Subtenant's obligations. No trust relationship is created herein between Sublandlord and Subtenant with respect to the Deposit. Any deposit under the Master Lease which may be returned by the Master Landlord shall be the property of Sublandlord at the end of the Sublease Term.

2.13 Brokers: Sublandlord is represented by Cornish & Carey Commercial (Fred Pilster, Agent) and Subtenant is represented by Equis (Dan Latini and Dede Satten, Agents) and both parties agree to such representation.

3. Premises. Sublandlord hereby leases to Subtenant and Subtenant hereby leases from Sublandlord, on and subject to the terms and conditions hereinafter set forth, the Premises.

4. Term. The term of this Sublease shall commence on the Commencement Date and end on the Expiration Date unless sooner terminated pursuant to any provision hereof, or of the Master Lease.

5. Base Monthly Rent. Beginning on the Commencement Date, Tenant shall pay the Base Monthly Rent as set forth in Paragraph 2.6 above and after the Adjustment Date, the Adjusted Rent pursuant to Paragraph 2.8 above, on the first day of each calendar month of the term (provided that no Base Monthly Rent shall actually be due and payable for the first month of the term as Tenant has prepaid such amount pursuant to Paragraph 2.6 above).

6. Delay of Possession. Notwithstanding said Commencement Date, if for any reason beyond Sublandlord's reasonable control Sublandlord cannot deliver possession of the Premises to Subtenant on said date, Sublandlord shall not be subject to any liability therefor, nor shall such failure affect the validity of this Sublease or the obligations of Subtenant hereunder or extend the term hereof, but in such case Subtenant shall not be obligated to pay rent until possession of the Premises is tendered to Subtenant; provided, however, that if Sublandlord shall not have delivered possession of the Premises within thirty (30) days from said Commencement Date, Subtenant may, at Subtenant's option, by notice in writing to Sublandlord within ten (10) days thereafter, cancel this Sublease, in which event the parties shall be discharged from all obligations thereunder. If this Sublease is canceled as herein provided, Sublandlord shall promptly return any monies previously deposited by Subtenant.

7. Early Entry. From and after the date of this Sublease and until the Commencement Date, and only upon twenty-four (24) hours prior notice to Sublessor, Subtenant and its authorized agents, contractors, subcontractors and employees shall be granted a license by Sublandlord to enter upon the Premises, at Subtenant's sole risk and expense, during ordinary business hours, for the sole purpose of installing Subtenant's trade fixtures and equipment in the Premises; provided, however, that the provisions of this Sublease, other than with respect to the payment of Basic Monthly Rent or Additional Rent (as defined in the Master Lease), shall apply during such early entry, including, but not limited to, Paragraph 9.6 below.

8. Prorations. Subtenant's Percentage Share of Common Operating Expenses (as defined in the Master Lease) payable by Sublandlord under the Master Lease and any other expenses incurred in the operation and maintenance of the Premises, shall be prorated as of the Commencement Date, with the Sublandlord being liable for all sums incurred prior to and the Subtenant being liable for all sums incurred subsequent to said Commencement Date; provided that if any of the aforesaid prorations cannot be calculated accurately as of the date of the execution of this Sublease, then the same shall be calculated as soon as reasonable practicable and either party owing the other party a sum of money based such subsequent proration(s) shall promptly pay said sums to the other party.

9. Incorporation By Reference; Assumption.

9.1 All of the Paragraphs of the Master Lease applicable to the Premises during the term hereof are

incorporated into this Sublease as if fully set forth in this Sublease except for the following: Article 2, Paragraphs 3.1, 3.2, and 3.5.

- 9.2 If any provisions of this Sublease conflict with any portion of the Master Lease, as incorporated herein, the terms of this Sublease shall govern.
- 9.3 Subtenant shall assume and perform to Sublandlord the tenant obligations under the Master Lease provisions incorporated into this Sublease pursuant to Paragraph 9.1 above, to the extent that the provisions are applicable to the Premises during the term hereof. Subtenant shall have no obligation or responsibility with respect to any tenant obligations required to be performed prior to the Commencement Date.
- 9.4 Subtenant shall pay to Sublandlord, as additional rent, Subtenant's Percentage Share of Common Operating Expenses payable by Sublandlord under the Master Lease applicable to the Premises not later than five (5) days prior to the date any such amounts are due and payable by Sublandlord; provided, however, Subtenant shall pay Subtenant's Percentage Share of estimated Common Operating Expenses (payable under Section 8.1 of the Master Lease) payable by Sublandlord under the Master Lease in advance in monthly installments on the first of the month with installments of Subtenant's Base Monthly Rent. Utilities shall be paid by Subtenant directly to the utility company.
- 9.5 With respect to work, services, repairs, repainting, restoration, the provision of utilities or HVAC services, or the performance of other obligations required of Master Landlord under the Master Lease, Sublandlord's sole obligation with respect thereto shall be to request the same, on request in writing by Subtenant, and to use reasonable efforts to obtain the same from Master Landlord. Subtenant shall cooperate reasonably with Sublandlord as may be required to obtain from Master Landlord any such work, services, repairs, repainting restoration, the provision of utilities, elevator or HVAC services, or the performance of any of Master Landlord other respective obligations under the Master Lease.
- 9.6 Subtenant shall comply with the provisions of Section 9.1 of the Master Lease by obtaining the required insurance policies and policy limits and naming Sublandlord as additional insured. Additionally, Subtenant shall be required to obtain and keep in force during the term of this Sublease, at its sole cost and expense, the statutory amount of worker's compensation insurance required by the State of California for the benefit of Subtenant's employees.
- 9.7 Sublandlord hereby agrees to provide Subtenant forty-eight (48) of the parking spaces granted to Sublandlord under the Master Lease.
- 9.8 In the event that pursuant to the Master Lease Sublandlord is entitled to any abatement of rent for reason of casualty, condemnation, failure to provide services, or the failure to perform obligations under the Master Lease, then Sublandlord shall likewise be entitled to an abatement of rent under this Sublease.
- 9.9 Notwithstanding anything contained herein to the contrary, upon expiration or earlier termination of this Sublease, Subtenant shall have no obligation to remove any furniture, equipment or improvements not placed in the Premises by Subtenant or its agents or contractors.

10. Subtenant's Performance Under Master Lease. At any time and on reasonable prior notice to Subtenant, Sublandlord can elect to require Subtenant to perform its obligations under this Sublease directly to Master Landlord, as applicable, in which event Subtenant shall send to Sublandlord from time to time copies of all notices and other communications it shall send to and receive from Master Landlord.

11. Covenant of Quiet Enjoyment. Sublandlord represents that the Master Lease attached hereto as Exhibit A is a true, complete and correct copy of the Master Lease, that the Master Lease is in full force and effect and that, to Sublandlord's actual knowledge, there are no defaults on Sublandlord's or Master Landlord's part under the Master Lease as of the Commencement Date. Subject to this Sublease terminating as provided herein or in the Master Lease (other than by reason of Sublandlord's default thereunder), Sublandlord represents that if Subtenant performs all the provisions in this Sublease to be performed by Subtenant, Subtenant shall have and enjoy throughout the term of this Sublease the quiet and undisturbed possession of the Premises by anyone claiming by or through Sublandlord. Sublandlord shall have the right to enter the Premises at any time, in the case of an emergency, and otherwise at reasonable times upon at least twenty-four (24) hours' advance notice, for the purpose of inspecting the condition of the Premises and for verifying compliance by Subtenant with this Sublease and the Master Lease and to permit Sublandlord to perform its obligations under this Sublease and the Master Lease.

12. Master Lease.

- 12.1 Subtenant shall not do or permit to be done anything which would constitute a violation or breach of any of the terms, conditions or provisions of the Master Lease or which would cause the Master Lease to be terminated or forfeited by virtue of any risks of termination or forfeiture reserved by or vested in Master Landlord, except to the extent that such act or occurrence shall have resulted, directly or indirectly, from a default by Sublandlord under this Sublease or the

failure of Sublandlord to comply with its obligations under the Master Lease not required to be performed by Subtenant pursuant to this Sublease.

- 12.2 Sublandlord shall not do or permit to be done anything which would constitute a violation or breach of any of the terms, conditions or provisions of the Master Lease or which would cause the Master Lease to be terminated or forfeited by virtue of any risks of termination or forfeiture reserved by or vested in Master Landlord, except to the extent that such act or occurrence shall have resulted, directly or indirectly, from a default by Subtenant under this Sublease (including without limitation, the failure of Subtenant to pay any amount of Base Monthly Rent or Subtenant's Percentage Share of Common Operating Expenses).
- 12.3 If the Master Lease terminates, this Sublease shall terminate and the parties shall be relieved from all liabilities and obligations under this Sublease; except that if the Master Lease or this Sublease terminates as a result of a default of Subtenant under this Sublease, Subtenant shall be liable to the Sublandlord for all damages suffered by Sublandlord as a result of the termination; and except that if the Master Lease or this Sublease terminates as a result of a default of Sublandlord under this Sublease, Sublandlord shall be liable to the Subtenant for all damages suffered by Subtenant as a result of the termination.

13. Hazardous Materials.

- 13.1 Subtenant shall provide Subtenant shall not store, use or dispose of any Hazardous Materials (as defined in the Master Lease) on, in or about the Premises in violation or breach of any of the terms, conditions or provisions of the Master Lease.
- 13.2 Subtenant has provided to Sublandlord and Master Landlord an accurately completed response to Master Landlord's standard form of Hazardous Materials Questionnaire attached hereto as Exhibit B (the "Questionnaire").
- 13.3 Subtenant's handling, storage, and use of Hazardous Materials on the Premises shall be limited to the types, amounts, and use identified on the Questionnaire. Subtenant shall provide written notice to Sublandlord updating the Questionnaire prior to bringing any new Hazardous Materials onto the Premises.
- 13.4 Subtenant shall comply with all rules, regulations and requirements promulgated by national, state or local governmental agencies or utility suppliers concerning its use and disposal of Hazardous Materials on the Premises and shall obtain and comply with all required operating permits and regulatory approvals, including, without limitation, transportation permits, wastewater discharge permits, and air emissions permits, and remain in compliance with all such permits or approvals while operating in the Premises during the term of this Sublease.
- 13.5 To the best of Sublandlord's knowledge, after reasonable inquiry, the Premises are not in violation of any federal, state, local or administrative agency ordinance, law, rule, regulation, order or requirement relating to environmental conditions or Hazardous Material. Subtenant expressly understands and agrees that the phrase "to the best of Sublandlord's knowledge" as used in this paragraph means the actual knowledge only of Mr. Ted Fong.

14. Indemnity. Subtenant will indemnify, defend (by counsel reasonably acceptable to Sublandlord), protect and hold Sublandlord harmless from and against any and all claims, demands, losses, damages, costs and expenses (including reasonable attorneys' fees) arising out of or relating to Subtenant's breach or default under this Sublease or use or occupancy of the Premises, or, to the extent incorporated herein, the Master Lease. Sublandlord will indemnify, defend (by counsel reasonably acceptable to Subtenant), protect and hold Subtenant harmless from and against any and all claims, demands, losses, damages, costs and expenses (including reasonable attorneys' fees) arising out of or relating to Sublandlord's willful misconduct or active negligence of which Sublandlord has actual notice and a reasonable opportunity to cure but fails to so cure).

15. Attorneys' Fees. If there is any legal or arbitration action or proceeding between Sublandlord and Subtenant to enforce any provision of this Sublease or to protect or establish any right or remedy of either Sublandlord or Subtenant hereunder, the unsuccessful party to such action or proceeding will pay to the prevailing party all costs and expenses, including reasonable attorneys' fees incurred by such prevailing party in such action or proceeding and in any appearance in connection therewith, and if such prevailing party recovers a judgment in any such action, proceeding or appeal, such costs, expenses and attorney's fees will be determined by the court or arbitration panel handling the proceeding and will be included in and as a part of such judgment.

16. Removal of Personal Property and Surrender. All articles of personal property, and all business and trade fixtures, machinery and equipment, cabinet work, furniture and movable partitions, if any, owned or installed by Subtenant at its expense in the Premises shall be and remain the property of Subtenant and may be removed by Subtenant at any time, provided that Subtenant, at its expense, shall repair any damage to the Premises caused by such removal or by the original installation. Sublandlord may elect to require Subtenant to remove all or any part of such property at the expiration or sooner termination of this Sublease (unless extended by Subtenant), in which event such removal shall be done at Subtenant's expense, and Subtenant shall at its own expense repair any damage to the Premises caused by such removal prior to the termination of this Sublease. Notwithstanding the above, at the termination of this Sublease, Subtenant shall surrender

the Premises in as good condition as received on the Commencement Date of this Sublease, wear and tear, casualty and condemnation excepted.

17. Maintenance and Repairs. Subtenant shall be responsible for all maintenance and repairs required to be performed by the tenant under the Master Lease with respect to the Premises during the term hereof.

18. Personal Property. The cubicles, furniture, cubicle cabling, telephone sets, and clean room equipment and support systems currently in place in the Premises including the De-ionized Water System, Acid Neutralization System, Life Safety Systems, Alarm System, Scrubber and Exhaust, Burn Box, Clean Dry Air System, Evaporative Cooling System, and Generator (the "Personal Property"), will be delivered by Sublandlord to Subtenant on the Commencement Date, in good working condition. Subtenant will have the use of the Personal Property during the term of this Sublease and any Extension periods at no additional charge of rent or fee. Subtenant accepts the Personal Property in its "as is" condition and Sublandlord makes no warranty as to the condition of the Personal Property or its present or future suitability for Subtenant's purposes.

19. Shared Building Systems.

19.1 Services Provided at No Charge:

- (a) Subtenant shall provide Sublandlord reasonable access to the Clean Dry Air System at no charge to Sublandlord.
- (b) For as long as Sublandlord requires De-ionized water from the Subtenant, Subtenant shall provide Sublandlord reasonable access to the De-ionized Water System at no charge. Subtenant shall use commercially reasonable efforts to maintain such equipment in good working order and to provide de-ionized water of quality no less than the specifications listed in Exhibit C attached hereto.

19.2 Services Provided at a Mutually Agreed Charge:

- (a) Subtenant shall allow Sublandlord to purchase nitrogen at the most favorable costs obtainable by either Sublandlord or Subtenant's cost on contract. Subtenant shall pay for the costs, if any, for installing a meter to determine the allocated usage of the nitrogen by Subtenant and Sublandlord.
- (b) The Sublandlord may provide Internet access, Internet security, network services, security camera surveillance or other services, provided that the cost for such services can be mutually agreed to.

19.3 During the term of this Sublease, Sublandlord shall provide to Subtenant the alarm and security services at the Premises (timed with Sublandlord's regular schedule and including security badge access capability).

19.4 In the event Subtenant, or its successors or assigns, continue to lease the Premises as a tenant of the Master Landlord following the expiration of the term of this Sublease and Sublandlord, or its successors or assigns, continue to lease the adjacent premises as a tenant of the Master Landlord the provisions of this Paragraph 19 shall survive for so long as Subtenant and Sublandlord or their respective successors and/or assigns continue to lease their respective premises.

20. Real Estate Brokers. Each party warrants to the other that there are no brokerage commissions or fees payable in connection with this Sublease except to the brokers set forth in Paragraph 2.13. Each party further agrees to indemnify and hold the other party harmless, from any cost, liability and expense (including attorney's fees), which the other party may incur as the result of any breach of this Paragraph 20.

21. Master Landlord Default; Consents. Notwithstanding any provision of this Sublease to the contrary, (a) Sublandlord shall not be liable or responsible in any way for any loss, damage, cost, expense, obligation or liability suffered by Subtenant by reason or as the result of any breach, default or failure to perform by the Master Landlord under the Master Lease; and (b) whenever the consent or approval of Sublandlord is required for a particular act, event or transaction (i) any such consent or approval by Sublandlord shall be subject to the consent or approval of Master Landlord, and (ii) should Master Landlord refuse to grant such consent or approval, under all circumstances, Sublandlord shall be released from any obligation to grant its consent or approval.

22. Notices. All notices given under this Sublease must be in writing and shall be delivered (a) in person, (b) by certified mail, postage prepaid, return receipt requested, (c) by a commercial overnight courier that guarantees next day delivery and provides a receipt, or (d) by telefacsimile or telecopy, and such notices shall be sent to the party at its address set forth in Paragraph 2.11 above. Those addresses may be changed by either party by written notice to the other party.

23. Special Notice. Should either party receive any notice of default under the Master Lease from Master Landlord, such party shall promptly cause a copy of such notice of default to be transmitted via facsimile to the other party at the fax number provided in Paragraph 2.11 above as well as mailing a copy to such other party at the addresses provided in Paragraph 2.11 above, provided that such requirement shall be deemed waived in any instance where the notice of default reflects on its face that it is being sent simultaneously to Sublandlord and Subtenant. Any further written communications between the parties and the Master Landlord regarding the status of such default shall



By: Orchard 702/703 Investors, LLC  
a Delaware limited liability company,  
its Managing Member

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

### CONSENT OF LANDLORD

Pursuant to a Lease Agreement (the "Lease") dated for reference purposes as of December 22, 2000, as amended on October 1, 2001, December 12, 2001, May 20, 2002 and March 15, 2005 (collectively, including the Amendments, referred to as the "Lease") between BRE/PCCP Orchard LLC, a Delaware limited liability company ("Landlord"), and Silicon Genesis Corporation, a California corporation ("Tenant"), relating to premises commonly known as 51 East Daggett Drive, San Jose, California (being 12,717 rentable square feet and referred to herein as the "Premises") as well as other space not subleased herein, in the County of Santa Clara (the "Premises"), Tenant has requested that Landlord consent to Tenant's Sublease dated December 10, 2005 and attached to this Consent as Exhibit "A" (the "Sublease") to Tegal Corporation, a Delaware corporation ("Subtenant") of the entire Premises to be subleased as described above (the "Subleased Premises") on the terms and conditions set forth in the Sublease.

In consideration of Tenant's and Subtenant's execution of this Consent of Landlord and agreement to the terms and conditions set forth in this Consent, Landlord consents to the Sublease of the Subleased Premises on the following terms and conditions:

- 1. Subrent:** Tenant and Subtenant represent and warrant to Landlord that the Sublease contains a complete and accurate statement of all money, property, value, and other consideration received or to be received from Subtenant in regard to the Sublease.
- 2. No Waiver:** This Consent does not constitute consent to any subsequent subletting or assignment, nor a waiver of the restriction on assignment and subletting contained in the Lease. Tenant and Subtenant agree that notwithstanding any contrary provision in the Sublease, the provisions of the Lease whereby Landlord is entitled to receive a portion of the difference between the Lease Rent and amounts received from a subtenant or an assignee, shall be applicable to Subtenant in regard to any further sub-sublease of the Subleased Premises or any assignment of the Sublease, such that Subtenant will pay such portion of the difference directly to Landlord.
- 3. Tenant's Primary Obligations:** Nothing herein shall release or alter the primary obligations of Tenant under the Lease, nor shall this Consent be deemed to create contractual obligations on the part of Landlord to the Subtenant. By executing this Consent, Subtenant agrees to assume all obligations of Tenant under the Lease related to the Subleased Premises arising after the date of the Sublease and to remain jointly and severally liable therefore with Tenant. Subtenant shall not, by this provision, assume any liability for obligations arising under the Lease but not relating to the Subleased Premises.
- 4. Costs and Attorney's Fees:** Landlord is entitled to be paid its reasonable costs and attorney's fees relating to this Consent. Tenant shall deliver to Landlord a check in the sum of \$1,200 representing Landlord's attorney's fees and costs along with the executed original of this Consent. In the event of any litigation arising hereunder, the prevailing party shall be entitled to recover reasonable attorney's fees and costs from the other party, and if due from Tenant, such fees shall constitute Additional Rent.
- 5. No Effect On Lease:** In no event shall Landlord's consent to this Sublease be, or be construed as, a modification of the terms of the Lease, and in the event of any inconsistency between any term of the Sublease and the terms of the Lease, the terms of the Lease shall prevail. By consenting to the Sublease, Landlord has not agreed to any purported duties or agreements set forth in the Sublease. Further, Landlord has not agreed to any language or undertaken any duties set forth or referenced in the Sublease except as such language and/or such duties are explicitly stated and set forth in this Consent.
- 6. Modifications; Notices:** Tenant and Subtenant agree that they will not amend, modify, supplement, extend, renew, or otherwise change the terms and provisions of the Sublease without the prior written consent of the Landlord, and that any modification, supplementation, renewal, or extension, by agreement or pursuant to an option granted in the Sublease, requires further written consent of Landlord, and will be considered a new sublease or assignment transaction subject to all provisions of the Lease relating thereto. Tenant and Subtenant will provide Landlord with courtesy copies of any notices or legal complaints or cross-complaints given or served by either of them in connection with the Sublease.
- 7. Hazardous Materials:** (a) Subtenant, at its sole cost, shall comply with all laws relating to the storage, use, and disposal of Hazardous Materials (as defined in the Lease) that Subtenant, its agents, employees, contractors, or invitees bring or permit to be brought on to the Subleased Premises or on the Premises or the Property. If Subtenant does store, use, or dispose of any Hazardous Materials, Subtenant shall notify Landlord in writing at least five (5) days prior to their first appearance on the Subleased Premises, and unless disclosed prior to the execution of this Consent in a response provided by Subtenant to Landlord's Hazardous Materials Questionnaire or other written disclosure, such Hazardous Materials shall not be stored, used, or disposed of on the Subleased or Premises without Landlord's advance written approval. Subtenant shall be subject to all obligations of Tenant under the Lease relating to Hazardous Materials (as defined therein).  
  
(b) Subtenant shall be responsible for and shall defend, indemnify, and hold Landlord and its agents harmless from and against all claims, costs and liabilities, including attorney's fees and costs, arising out of or in connection with the storage, use, or disposal of Hazardous Materials in or about the Subleased Premises, the Premises, or the Property by Subtenant, its agents, employees, contractors, or invitees which occur prior to or after the date of the Sublease, but Tenant shall remain responsible for any such matters to the extent set forth in the Lease, and Subtenant's responsibility and duty as set forth above shall not relieve Tenant of its responsibilities and duties pursuant to the Lease.

8. **Construction and Signage:** Any and all construction to be performed by Tenant or Subtenant on the Subleased Premises shall be subject to the advance written approval of Landlord as set forth in the Lease. Any signage called for in the Sublease shall be subject to Landlord's approval as per the terms of the Lease, and subject to the procurement of approval and permits from the City in which the Premises are located. By approving the Sublease, Landlord shall not be deemed to have approved any signage or construction referenced therein.
9. **Insurance and Indemnity:** The Subtenant shall comply with all of the insurance provisions of the Lease as if it were the Tenant named thereunder, and shall name the Landlord as an additional insured on all policies of insurance required by the Sublease and Lease, and provide the Landlord with a documentary proof thereof as required by the Lease. Subtenant releases Landlord and its agents and employees, from any liability for injury to any person or damage to property that is caused by or results from any risk insured against under (1) any insurance policy carried by Subtenant or Tenant and in force at the time of such injury or damage, and/or (2) any insurance policy which Subtenant was required by this Consent, the Lease, or the Sublease to have in force. Subtenant shall cause each insurance policy obtained by it to provide that the insurer waives all right of recovery by way of subrogation against Landlord and its agents and employees in connection with any injury or damage to property. Subtenant shall hold harmless, indemnify and defend Landlord and its employees and agents (with counsel reasonably satisfactory to Landlord) from all liability, penalties, losses, damages, costs, expenses, causes of action, claims and/or judgments arising by reason of any death, bodily injury, personal injury or property damage arising from (i) any occurrence on the Subleased Premises during the Sublease Term or any period of Subtenant's occupancy (unless caused by the gross negligence or willful misconduct of Landlord or its agents), (ii) any occurrence on the Premises or Landlord's Property caused by Subtenant or its employees or agents (unless caused by the gross negligence or willful misconduct of Landlord or its agents), and (iii) the negligence or willful misconduct of Tenant or its employees and agents wherever occurring. The provisions of this Paragraph shall survive the expiration or sooner termination of this Lease.
10. **Use:** Subtenant shall use the Subleased Premises only for the uses allowed by the Lease and for no other purpose.
11. **Assignment Of Tenant's Rights:** Tenant irrevocably assigns to Landlord, as security for the performance of each and all of Tenant's obligations under the Lease, all rent and other consideration received or to be received from Subtenant. Landlord, as assignee of Tenant, or a receiver appointed on Landlord's application, may (but is not required to) collect such rent or other consideration, provided, however, that until and unless Tenant commits an Event of Tenant's Default under the Lease, Tenant shall have the right to collect such rent or other consideration (subject to any obligation set forth in the Lease whereby Tenant is to pay all or a part of such rent or other consideration to Landlord). Such assignment shall be subject to the following terms and conditions:
- (a) Landlord may collect such rent or other consideration from Subtenant only so long as Tenant shall continue to be in default of its obligations under the Lease.
  - (b) Upon Landlord's written request following the occurrence of an Event of Default under the Lease, Tenant shall execute such documents as are reasonably requested by Landlord for the purpose of confirming to Subtenant that Landlord has the right to collect all rent and other consideration otherwise due to Tenant from such subtenant or assignee.
  - (c) Subtenant has the right and duty to pay rent or other consideration otherwise due to Tenant directly to Landlord upon receipt from Landlord of a written statement that an Event of Tenant's Default exists under the Lease, and in such event, each payment made by Subtenant to Landlord shall be deemed to satisfy the obligations of Subtenant to Tenant, but only to the extent of such payment.
  - (d) Subtenant's payment to Landlord pursuant to this assignment shall not create or evidence any direct landlord tenant relationship between Subtenant and Landlord, and Landlord may exercise all remedies to terminate the Lease (including the termination of Subtenant's possession of the Premises or the Subleased Premises) in the event of any Event of Default by Tenant, notwithstanding its receipt of any payment from Subtenant pursuant to this assignment, unless the receipt of such payment completely cures Tenant's default. The acceptance of a payment from Subtenant pursuant to this assignment shall not affect Landlord's right to its remedies for Tenant's default.
12. **Termination:** The Sublease is and remains subject and subordinate to the Lease, and a termination of the Lease for any reason (including but not limited to a default of Tenant) shall terminate the Sublease.
13. **Brokerage Commissions:** Notwithstanding anything set forth in the Sublease, Landlord has no obligation to pay and will not pay commissions or fees to any broker or finder in regard to the Sublease or Landlord's consent thereto. Tenant and Subtenant will hold Landlord harmless and indemnify and defend Landlord against any claims for brokerage commissions arising in regard to the Sublease or Landlord's consent thereto.
14. **Construction:** This Consent has been reviewed and negotiated through discussions between the parties at arm's length. No rule of construction under which ambiguities are to be resolved against drafting parties shall be applicable hereto or employed in the interpretation of the Consent.

**LANDLORD:**

BRE/PCCP ORCHARD, L.L.C.  
a Delaware limited liability company

By: ORCHARD 702/703 Investors, LLC, a  
Delaware limited liability company, its Member

**TENANT:**

Silicon Genesis Corporation, a California  
corporation

/s/ Theodore E. Fong

By: /s/ Michael J. Biggar  
Michael J. Biggar  
Managing Member

By Theodore E. Fong  
[Print Name and Title]  
Dated: 12/29/05

Dated: 1/4/06

**SUBTENANT**

Tegal Corporation, a Delaware corporation

/s/ Thomas R. Mika

By THOMAS R. MIKA  
[Print Name and Title]

Dated: 12/30/05

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EXHIBIT A

MASTER LEASE

1. Lease dated for reference purposes as of December 22, 2000
2. First Amendment to Lease dated October 1, 2001
3. Second Amendment to Lease dated December 12, 2001
4. Third Amendment to Lease dated May 20, 2002
5. Fourth Amendment to Lease dated March 15, 2005

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EXHIBIT B

**[ATTACH ORCHARD COMMERCIAL, INC.**

**HAZARDOUS MATERIALS QUESTIONNAIRE]**

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EXHIBIT C

De-ionized Water Specifications:

Resistivity Sustained 18.1 Mohms @ 25(Degree)C as measured with flow-through cell and meter per ASTM-D-1125. Reported as meg ohm(s) per cm. 17.9 Mohms @ 25(Degree)C minimum

Bacteria Less than 5 colony forming units per 100 ml tested per ASTM-F-6065T.

TOC: Total oxidizable carbons less than 5 ppb as measured by a Sievers TOC analyzer. Reported as parts per billion. Excluding THMs.

Silica: Less than 5 ppb. Reported as parts per billion.



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

I, Thomas R. Mika, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tegal Corporation;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-14(e)) for the registrant and we have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
  - (c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (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 controls over financial reporting.

Date: February 10, 2006

/s/ Thomas R. Mika  
Chief Executive Officer and President

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

I, Christine Hergenrother, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tegal Corporation;
2. Based on my knowledge, this 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 report;
3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-14(e)) for the registrant and we have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
  - (c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
  - (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 controls over financial reporting.

Date: February 10, 2006

/s/ Christine Hergenrother  
Chief Financial Officer

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

In connection with the Quarterly Report of Tegal Corporation, a Delaware corporation (the "Company"), on Form 10-Q for the quarter ending December 31, 2005 as filed with the Securities and Exchange Commission (the "Report"), I, Thomas R. Mika, President and Chief Executive Officer of the Company, certify, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350), that to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Thomas R. Mika  
Chief Executive Officer and President  
February 10, 2006

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

In connection with the Quarterly Report of Tegal Corporation, a Delaware corporation (the "Company"), on Form 10-Q for the quarter ending December 31, 2005 as filed with the Securities and Exchange Commission (the "Report"), I, Christine Hergenrother, Chief Financial Officer of the Company, certify, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1350), that to my knowledge:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Christine Hergenrother  
Chief Financial Officer  
February 10, 2006