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

FORM 10-Q

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

For the quarterly period ended September 30, 2012

or

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

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

Commission File Number 001-33216

OCULUS INNOVATIVE SCIENCES, INC.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

68-0423298  
(I.R.S Employer  
Identification No.)

1129 North McDowell Blvd.  
Petaluma, CA 94954  
(Address of principal executive offices) (Zip Code)

(707) 283-0550  
Registrant's telephone number, including area code

Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer      Accelerated filer      Non-accelerated filer      Smaller reporting company  
£                                      £                                      (Do not check if a smaller reporting company)                                      

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of November 2, 2012, the number of shares outstanding of the registrant's common stock, \$0.0001 par value, was 37,089,888.

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**OCULUS INNOVATIVE SCIENCES, INC.**

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES**

**Condensed Consolidated Balance Sheets**

(In thousands, except share and per share amounts)

	<b>September 30, 2012</b>	<b>March 31, 2012</b>
	<b>(Unaudited)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 8,310	\$ 3,351
Accounts receivable, net	2,842	2,151
Inventories, net	876	953
Prepaid expenses and other current assets	419	505
Total current assets	<u>12,447</u>	<u>6,960</u>
Property and equipment, net	730	806
Other assets	215	72
Total assets	<u>\$ 13,392</u>	<u>\$ 7,838</u>
<b>LIABILITIES AND STOCKHOLDERS' DEFICIENCY</b>		
Current liabilities:		
Accounts payable	\$ 783	\$ 816
Accrued expenses and other current liabilities	765	844
Deferred revenue	2,874	1,619
Current portion of long-term debt, net of debt discount of \$615 and \$624 at September 30, 2012 (unaudited) and March 31, 2012, respectively	1,477	1,415
Derivative liability	1,552	55
Total current liabilities	<u>7,451</u>	<u>4,749</u>
Deferred revenue, less current portion	3,350	133
Long-term debt, net of debt discount of \$475 and \$769 at September 30, 2012 (unaudited) and March 31, 2012, respectively, less current portion	1,092	1,824
Put warrant liability	2,000	2,000
Total liabilities	<u>13,893</u>	<u>8,706</u>
Commitments and Contingencies		
Stockholders' Deficiency:		
Convertible preferred stock, \$0.0001 par value; 5,000,000 shares authorized, no shares issued and outstanding at September 30, 2012 (unaudited) and March 31, 2012	-	-
Common stock, \$0.0001 par value; 100,000,000 shares authorized, 32,768,903 and 29,007,903 shares issued and outstanding at September 30, 2012 (unaudited) and March 31, 2012, respectively	3	3
Additional paid-in capital	135,938	134,496
Accumulated other comprehensive loss	(3,054)	(3,053)
Accumulated deficit	(133,388)	(132,314)
Total stockholders' deficiency	<u>(501)</u>	<u>(868)</u>
Total liabilities and stockholders' deficiency	<u>\$ 13,392</u>	<u>\$ 7,838</u>

See accompanying notes.

**OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Operations**  
(In thousands, except per share amounts)  
(Unaudited)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Revenues				
Product	\$ 3,890	\$ 3,296	\$ 7,674	\$ 5,911
Product licensing fees	374	94	406	189
Service	262	273	497	503
Total revenues	<u>4,526</u>	<u>3,663</u>	<u>8,577</u>	<u>6,603</u>
Cost of revenues				
Product	1,092	668	2,080	1,458
Service	234	217	413	418
Total cost of revenues	<u>1,326</u>	<u>885</u>	<u>2,493</u>	<u>1,876</u>
Gross profit	<u>3,200</u>	<u>2,778</u>	<u>6,084</u>	<u>4,727</u>
Operating expenses				
Research and development	513	560	1,045	996
Selling, general and administrative	3,504	2,848	6,351	6,379
Total operating expenses	<u>4,017</u>	<u>3,408</u>	<u>7,396</u>	<u>7,375</u>
Loss from operations	(817)	(630)	(1,312)	(2,648)
Interest expense	(280)	(230)	(568)	(392)
Interest income	1	1	2	2
(Loss) gain due to change in fair value of derivative instruments	(397)	121	850	218
Other expense, net	(26)	(101)	(46)	(194)
Net loss	(1,519)	(839)	(1,074)	(3,014)
Preferred stock deemed dividend	-	-	(1,062)	-
Net loss available to common shareholders	<u>\$ (1,519)</u>	<u>\$ (839)</u>	<u>\$ (2,136)</u>	<u>\$ (3,014)</u>
Net loss per common share: basic and diluted	<u>\$ (0.05)</u>	<u>\$ (0.03)</u>	<u>\$ (0.07)</u>	<u>\$ (0.11)</u>
Weighted-average number of shares used in per common share calculations:				
Basic and diluted	<u>32,616</u>	<u>26,828</u>	<u>32,111</u>	<u>26,771</u>
Other comprehensive loss, net of tax				
Net loss	\$ (1,519)	\$ (839)	\$ (1,074)	\$ (3,014)
Foreign currency translation adjustments	119	(174)	(1)	(207)
Other comprehensive loss	<u>\$ (1,400)</u>	<u>\$ (1,013)</u>	<u>\$ (1,075)</u>	<u>\$ (3,221)</u>

See accompanying notes.

**OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Cash Flows**  
(In thousands)  
(Unaudited)

	<b>Six Months Ended</b>	
	<b>September 30,</b>	
	<b>2012</b>	<b>2011</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (1,074)	\$ (3,014)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	136	166
Stock-based compensation	941	1,327
Change in fair value of derivative liability	(850)	(218)
Non-cash interest expense	303	175
Foreign currency transaction losses	7	57
Changes in operating assets and liabilities:		
Accounts receivable, net	(705)	(163)
Inventories, net	70	(218)
Prepaid expenses and other current assets	84	256
Accounts payable	(28)	(47)
Accrued expenses and other liabilities	4,408	211
Net cash provided by (used in) operating activities	<u>3,292</u>	<u>(1,468)</u>
<b>Cash flows from investing activities:</b>		
Change in other assets	(62)	(72)
Purchases of property and equipment	(143)	(102)
Net cash used in investing activities	<u>(205)</u>	<u>(174)</u>
<b>Cash flows from financing activities:</b>		
Proceeds from the issuance of common stock, net of offering costs	1,925	–
Proceeds from the issuance of convertible preferred stock, net of offering costs	907	–
Proceeds from the exercise of common stock options and warrants	16	24
Proceeds from issuance of long-term debt	–	1,500
Principal payments on long-term debt	(974)	(575)
Net cash provided by financing activities	1,874	949
Effect of exchange rate on cash and cash equivalents	(2)	(56)
Net increase (decrease) in cash and cash equivalents	4,959	(749)
Cash and equivalents, beginning of period	3,351	4,371
Cash and equivalents, end of period	<u>\$ 8,310</u>	<u>\$ 3,622</u>
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for interest	<u>\$ 265</u>	<u>\$ 217</u>
<b>Non-cash financing activities:</b>		
Debt discount in connection with long-term debt	<u>\$ –</u>	<u>\$ 1,094</u>

See accompanying notes.

**OCULUS INNOVATIVE SCIENCES, INC. AND SUBSIDIARIES**  
**Notes to Condensed Consolidated Financial Statements**  
(Unaudited)

**Note 1. Organization and Summary of Significant Accounting Policies**

***Organization***

Oculus Innovative Sciences, Inc. (the “Company”) was incorporated under the laws of the State of California in April 1999 and was reincorporated under the laws of the State of Delaware in December 2006. The Company’s principal office is located in Petaluma, California. The Company is a commercial healthcare company that designs, produces, and markets innovative, safe and effective drugs, devices, and nutritional products. It is pioneering innovative products for the dermatology, surgical, wound care, and animal healthcare markets. The Company’s primary focus is on its proprietary technology platform called Microcyn® Technology. This technology is based on electrically charged oxychlorine small molecules designed to target a wide range of organisms that cause disease (pathogens). Several Microcyn® Technology tissue care products are designed to treat infections and enhance healing while reducing the need for antibiotics.

***Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements as of September 30, 2012 and for the three and six months then ended have been prepared in accordance with the accounting principles generally accepted in the United States of America for interim financial information and pursuant to the instructions to Form 10-Q and Article 8 of Regulation S-X of the Securities and Exchange Commission (“SEC”) and on the same basis as the Company prepares its annual audited consolidated financial statements. The unaudited condensed consolidated balance sheet as of September 30, 2012, condensed consolidated statements of operations for the three and six months ended September 30, 2012 and 2011, and the condensed consolidated statements of cash flows for six months ended September 30, 2012 and 2011 are unaudited, but include all adjustments, consisting only of normal recurring adjustments, which the Company considers necessary for a fair presentation of the financial position, operating results and cash flows for the periods presented. The results for the three and six months ended September 30, 2012 are not necessarily indicative of results to be expected for the year ending March 31, 2013 or for any future interim period. The condensed consolidated balance sheet at March 31, 2012 has been derived from audited consolidated financial statements; however, it does not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete consolidated financial statements. The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended March 31, 2012, and notes thereto included in the Company’s annual report on Form 10-K, which was filed with the SEC on June 21, 2012.

***Use of Estimates***

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the dates of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates. Significant estimates and assumptions include reserves and write-downs related to receivables and inventories, the recoverability of long-lived assets, deferred taxes and related valuation allowances, valuation of equity and derivative instruments, debt discounts and estimated amortization periods for upfront fees received from customers. Periodically, the Company evaluates and adjusts estimates accordingly. The allowance for uncollectible accounts receivable balances amounted to \$74,000 and \$52,000, which are included in accounts receivable, net in the accompanying September 30, 2012 and March 31, 2012 condensed consolidated balance sheets, respectively. The reserve for excess and obsolete inventory balances amounted to \$129,000 and \$105,000, which are included in inventories, net in the accompanying September 30, 2012 and March 31, 2012 condensed consolidated balance sheets, respectively

***Reclassifications***

Certain prior period amounts have been reclassified for comparative purposes to conform to the fiscal 2013 presentation. These reclassifications have no impact on the Company’s previously reported net loss.

***Net Loss per Share***

The Company computes basic net loss per share by dividing net loss per share available to common stockholders by the weighted average number of common shares outstanding for the period and excludes the effects of any potentially dilutive securities. Diluted earnings per share, if presented, would include the dilution that would occur upon the exercise or conversion of all potentially dilutive securities into common stock using the “treasury stock” and/or “if converted” methods as applicable. The computation of basic net loss per share for the three and six months ended September 30, 2012 and 2011 excludes the potentially dilutive securities summarized in the table below because their inclusion would be anti-dilutive.

	September 30,	
	2012	2011
	(in thousands)	
Options to purchase common stock	6,915	5,603
Warrants to purchase common stock	10,706	9,602
	<u>17,621</u>	<u>15,205</u>

#### ***Common Stock Purchase Warrants and Other Derivative Financial Instruments***

The Company classifies common stock purchase warrants and other free standing derivative financial instruments as equity if the contracts (i) require physical settlement or net-share settlement or (ii) give the Company a choice of net-cash settlement or settlement in its own shares (physical settlement or net-share settlement). The Company classifies any contracts that (i) require net-cash settlement (including a requirement to net cash settle the contract if an event occurs and if that event is outside the control of the Company), (ii) give the counterparty a choice of net-cash settlement or settlement in shares (physical settlement or net-share settlement), or (iii) contain reset provisions as either an asset or a liability. The Company assesses classification of its freestanding derivatives at each reporting date to determine whether a change in classification between assets and liabilities is required. The Company determined that its freestanding derivatives, which principally consist of warrants to purchase common stock, satisfied the criteria for classification as equity instruments at September 30, 2012, other than certain warrants that contain reset provisions and certain warrants that require net-cash settlement that the Company classified as derivative liabilities as more fully described in Note 5.

#### ***Preferred Stock***

Shares that are subject to mandatory redemption (if any) are classified as liability instruments and are measured at fair value. The Company classifies conditionally redeemable preferred shares, which includes preferred shares that feature redemption rights that are either within the control of the holder or subject to redemption upon the occurrence of uncertain events not solely within the Company's control, as temporary equity.

#### ***Convertible Instruments***

The Company evaluates and bifurcates conversion options from their host instruments and accounts for them as free standing derivative financial instruments according to certain criteria. The criteria include circumstances in which (a) the economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract, (b) the hybrid instrument that embodies both the embedded derivative instrument and the host contract is not re-measured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings as they occur and (c) a separate instrument with the same terms as the embedded derivative instrument would be considered a derivative instrument. An exception to this rule is when the host instrument is deemed to be conventional as that term is described under applicable Generally Accepted Accounting Principles ("GAAP").

#### ***Fair Value of Financial Assets and Liabilities***

Financial instruments, including cash and cash equivalents, accounts payable and accrued liabilities are carried at cost, which management believes approximates fair value due to the short-term nature of these instruments. The fair value of capital lease obligations and equipment loans approximates their carrying amounts as a market rate of interest is attached to their repayment. The Company measures the fair value of financial assets and liabilities based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. The Company uses three levels of inputs that may be used to measure fair value:

Level 1 — quoted prices in active markets for identical assets or liabilities

Level 2 — quoted prices for similar assets and liabilities in active markets or inputs that are observable

Level 3 — inputs that are unobservable (for example cash flow modeling inputs based on assumptions)

Financial liabilities measured at fair value on a recurring basis are summarized below:

	<b>Fair value measurements (in thousands) at September 30, 2012 using</b>			
	<b>September 30, 2012</b>	<b>Quoted prices in active markets for identical assets (Level 1)</b>	<b>Significant other observable inputs (Level 2)</b>	<b>Significant unobservable inputs (Level 3)</b>
Liabilities:				
Fair value of warrant obligations (Note 5)	\$ 1,552	–	–	\$ 1,552

	<b>Fair value measurements (in thousands) at March 31, 2012 using</b>			
	<b>March 31, 2012</b>	<b>Quoted prices in active markets for identical assets (Level 1)</b>	<b>Significant other observable inputs (Level 2)</b>	<b>Significant unobservable inputs (Level 3)</b>
Liabilities:				
Fair value of warrant obligations (Note 5)	\$ 55	–	–	\$ 55

Level 3 liabilities are valued using unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the derivative liabilities. For fair value measurements categorized within Level 3 of the fair value hierarchy, the Company's accounting and finance department, who report to the Chief Financial Officer, determine its valuation policies and procedures. The development and determination of the unobservable inputs for Level 3 fair value measurements and fair value calculations are the responsibility of the Company's accounting and finance department and are approved by the Chief Financial Officer.

#### Level 3 Valuation Techniques:

Level 3 financial liabilities consist of the derivative liabilities for which there is no current market for these securities such that the determination of fair value requires significant judgment or estimation. Changes in fair value measurements categorized within Level 3 of the fair value hierarchy are analyzed each period based on changes in estimates or assumptions and recorded as appropriate.

The Company uses the Black-Scholes option valuation model to value Level 3 financial liabilities at inception and on subsequent valuation dates. This model incorporates transaction details such as the Company's stock price, contractual terms, maturity, risk free rates, as well as volatility.

A significant decrease in the volatility or a significant decrease in the Company's stock price, in isolation, would result in a significantly lower fair value measurement. Changes in the values of the derivative liabilities are recorded in "(Loss) gain due to change in fair value of derivative instruments" in the Company's condensed consolidated statements of operations.

As of September 30, 2012, there were no transfers in or out of Level 3 from other levels in the fair value hierarchy.

#### ***Subsequent Events***

Management has evaluated subsequent events or transactions occurring through the date the financial statements were issued (Note 11).

#### **Note 2. Liquidity and Financial Condition**

The Company reported a net loss of \$1,074,000 for the six months ended September 30, 2012. At September 30, 2012, the Company's accumulated deficit amounted to \$133,388,000. The Company had working capital of \$4,996,000 as of September 30, 2012. The Company may need to raise additional capital from external sources in order to continue the longer term efforts contemplated under its business plan. The Company expects to continue incurring losses for the foreseeable future and may need to raise additional capital to pursue its product development initiatives, penetrate markets for the sale of its products and continue as a going concern.

On April 22, 2012, the Company entered into agreements with various investors to issue up to: a) 2,360,001 shares of common stock; b) 1,000 shares of Series A 0% Convertible Preferred Stock (the "Series A Preferred Stock"); and c) warrants to purchase up to 3,471,112 shares of common stock (the "Warrants"). The Company also offered up to 1,111,111 shares of common stock issuable upon conversion of the Series A Preferred Stock and 3,471,112 shares of common stock in the event the Warrants are exercised. The Warrants have an initial exercise price of \$1.18 per share, are not exercisable for six months from the date of issuance, and have an exercise term of 2.5 years from the date of issuance. The Company received approximately \$3,124,000 in gross proceeds from the sale of these securities. Net proceeds after deducting the placement agent commissions, legal expenses and other offering expenses, and assuming no exercise of the Warrants, was \$2,832,000. The Company retained Rodman & Renshaw, LLC as the exclusive placement agent for this offering, and paid them \$218,680 in placement agent commissions. On May 4, 2012, the investor converted 1,000 shares of the Series A Preferred Stock purchased



in the transaction into 1,111,111 shares of common stock.

The Company currently anticipates that its cash and cash equivalents will be sufficient to meet its working capital requirements to continue its sales and marketing and research and development through at least October 1, 2013. However, in order to execute the Company's long-term Microcyn® product development strategy and to penetrate new and existing markets, the Company may need to raise additional funds through public or private equity offerings, debt financings, corporate collaborations or other means.

Management believes that the Company has access to capital resources through possible public or private equity offerings, debt financings, corporate collaborations or other means; however, the Company has not secured any commitment for new financing at this time, nor can it provide any assurance that new financing will be available on commercially acceptable terms, if needed. If the Company is unable to secure additional capital, it may be required to curtail its research and development initiatives and take additional measures to reduce costs in order to conserve its cash.

### **Note 3. Condensed Consolidated Balance Sheets**

#### ***Inventories***

Inventories consisted of the following (in thousands):

	<u>September 30,</u> <u>2012</u>	<u>March 31,</u> <u>2012</u>
	<u>(unaudited)</u>	
Raw materials	\$ 626	\$ 558
Finished goods	379	500
	<u>1,005</u>	<u>1,058</u>
Less: inventory allowances	(129)	(105)
	<u>\$ 876</u>	<u>\$ 953</u>

### **Note 4. Commitments and Contingencies**

#### ***Legal Matters***

On July 25, 2011, the Company received notice of a lawsuit filed in Mexico by Cesar Mangotich Pacheco and Prodinnv, S.A. de C.V. represented by Cesar Mangotich Pacheco. The lawsuit appears to allege conversion of assets, tortious interference and defamation, among other claims. The Company is currently evaluating the lawsuit, conferring with local counsel and translating the documents it has received. The Company's preliminary assessment is that the lawsuit is completely without merit and intends to vigorously defend its position. The Company has not accrued a loss reserve for this matter.

The Company, from time to time, is involved in legal matters arising in the ordinary course of its business including matters involving proprietary technology. While management believes that such matters are currently not material, there can be no assurance that matters arising in the ordinary course of business for which the Company is or could become involved in litigation, will not have a material adverse effect on its business, financial condition or results of operations.

#### ***Employment Agreements with Executives***

As of September 30, 2012, the Company had employment agreements in place with five of its key executives. The agreements provide, among other things, for the payment of six to twenty-four months of severance compensation for terminations under certain circumstances. With respect to these agreements, at September 30, 2012, potential severance amounted to \$1,918,000 and aggregated annual salaries amounted to \$1,360,000.

#### ***Commercial Agreements***

On February 14, 2011, the Company announced the formation of a broad multi-year collaboration with Amneal Enterprises to realize the development and commercial potential of Microcyn® Technology. Amneal Enterprises is an affiliation of independent pharmaceutical marketing, discovery and development companies. As a part of this collaboration, the Company entered into a product option agreement with an Amneal affiliate, AmDerma Pharmaceuticals, LLC ("AmDerma") and the Company sold the option to exclusively sell and distribute the future Microcyn-based acne product to AmDerma for a one-time non-refundable payment of \$500,000. On June 23, 2011, AmDerma exercised its option to license rights to the drug candidate.

On June 21, 2012, the Company entered into a collaboration agreement with AmDerma (the "Collaboration Agreement"). Pursuant to the Collaboration Agreement, AmDerma is responsible for the development of a Microcyn-based acne drug candidate in the United States, including all activities required to gain regulatory approvals. AmDerma will also be responsible for all costs. Additionally, within one year of the first commercial sale by AmDerma, AmDerma shall identify at least one secondary indication that AmDerma will develop. If AmDerma declines to pursue such secondary indication, then the right to develop such secondary indication will revert back to the Company. The Company granted AmDerma an exclusive, royalty-bearing perpetual license in the United States and India, with the right to sublicense and subcontract in certain circumstances, and a right of first refusal to expand the territory of the license to include the European Union, Canada, Brazil, and Japan. The Company retained rights to the "rest of world." The aforementioned option payment of \$500,000 will be applied against future milestone payments in the transaction. This amount is recorded as deferred revenue in the September 30, 2012 and March 31, 2012 accompanying condensed consolidated balance sheets.

On August 9, 2012, the Company, along with its Mexican subsidiary and manufacturer Oculus Technologies of Mexico S.A. de C.V. (“Manufacturer”), entered into a license, exclusive distribution and supply agreement with More Pharma Corporation, S. de R.L. de C.V. (“More Pharma”) (the “License Agreement”). For a one-time payment of \$500,000, the Company granted More Pharma an exclusive license, with the right to sublicense under certain conditions and with the Company’s consent, to all of the Company’s proprietary rights related to certain of its pharmaceutical products for human application that utilize the Company’s Microcyn® Technology within Mexico. For an additional one-time payment of \$3,000,000, the Company also agreed to appoint More Pharma as the exclusive distributor of certain of its products in Mexico for the term of the agreement. Additionally, Manufacturer granted More Pharma an exclusive license to certain of Manufacturer’s then-held trademarks in exchange for a payment of \$100,000 to Manufacturer. The Company has the ability to terminate the agreement if certain annual purchase minimums are not met. The term of the agreement is twenty-five years from the effective date of August 15, 2012 (the “Effective Date”). The term of the License Agreement will automatically renew after the twenty-five year term for successive two year terms as long as More Pharma has materially complied with any and all of the obligations under the License Agreement, including but not limited to, meeting the minimum purchase requirements set forth therein.

Additionally, also on August 9, 2012, the Company, along with Manufacturer, also entered into an exclusive distribution and supply agreement with More Pharma (the “Distribution Agreement”). For a one-time payment of \$1,500,000, the Company granted More Pharma exclusive ability to market and sell certain of its pharmaceutical products for human application that utilize the Company’s Microcyn® Technology. The Company also appointed More Pharma as its exclusive distributor, with the right to execute sub-distribution agreements under certain conditions and with the Company’s consent, within the following countries: Antigua & Barbuda, Argentina, Aruba & Curacao, Bahamas, Barbados, Belize, Bolivia, Bonaire, Brazil, British Guyana, British Islands, Cayman Islands, Chile, Colombia, Cuba, Dominica, Dominican Republic, Ecuador, El Salvador, French Guyana, Grenada, Guadalupe, Guatemala, Haiti, Honduras, Jamaica, Martinique, Nicaragua, Paraguay, Peru, St. Bartolome, St. Vincent & Grenades, Surinam, Trinidad & Tobago, Turks & Caicos Islands, Uruguay, Venezuela and Virgin Islands (the “Territory”).

The Company will recognize the \$5,100,000 related to the License Agreement and the Distribution Agreement as revenue on a straight line basis consistent with the Company’s historical experience with contracts with similar terms, which is typically over three to five years of the contract. Additionally, the Company capitalized \$214,000 of its transaction costs related to the agreements, which will be amortized by the Company as expense on a straight line basis consistent with the related revenue recognition practices. At September 30, 2012, the Company had outstanding accounts receivable of \$444,000 related to its transaction with More Pharma. During the three months ended September 30, 2012, the Company recognized \$183,000 as revenue related to the upfront fees of the transaction and recognized \$8,000 as an expense. The Company will recognize upcoming product sales on a sell-through basis as More Pharma sells products through to its customers.

#### ***Related Party Agreements***

On January 26, 2009, the Company entered into a commercial agreement with VetCure, Inc., a California corporation, to market and sell its Vetericyn products. VetCure, Inc. later changed its name to Vetericyn, Inc., which, at the time, was wholly-owned by Mr. Robert Burlingame. This agreement was amended on February 24, 2009, July 24, 2009, June 1, 2010, and November 1, 2010. Pursuant to the agreement, the Company provides Vetericyn, Inc. with bulk product and Vetericyn, Inc. bottles, packages, and sells Vetericyn products. The Company receives a fixed amount for each bottle of Vetericyn sold by Vetericyn, Inc. At the time of these 2009 transactions, Vetericyn was wholly-owned by Mr. Burlingame, who was also a director of the Company at that time. Mr. Burlingame resigned from the Company’s board of directors on February 10, 2010. After his resignation, Mr. Burlingame continued to own a significant portion of the Company’s stock from a transaction in 2009. To the Company’s knowledge, he ceased being a holder of more than 5% of its common stock in 2010.

On September 15, 2009, the Company entered a commercial agreement with V&M Industries, Inc., a California corporation, to market and sell its Microcyn over-the-counter liquid and gel products. V&M Industries, Inc. subsequently changed its name to Innovacyn, Inc. On June 1, 2010, September 1, 2010, and November 1, 2010, the Company amended this agreement granting Innovacyn, Inc. the exclusive right to sell certain of its over-the-counter products. At the time of the 2009 transaction, V&M Industries, Inc. was wholly-owned by Robert Burlingame, who was also a director of the Company at that time. Mr. Burlingame resigned from the Company’s board of directors on February 10, 2010. After his resignation, Mr. Burlingame continued to own a significant portion of the Company’s stock from a transaction in 2009. To the Company’s knowledge, he ceased being a holder of more than 5% of its common stock in 2010.

Additionally, beginning on July 1, 2011, the Company shares profits related to Vetericyn and Microcyn over-the-counter sales. During the three months ended September 30, 2012 and 2011, the Company recorded revenue related to these agreements in the amounts of \$1,229,000 and \$1,176,000, respectively. During the six months ended September 30, 2012 and 2011, the Company recorded revenue related to these agreements in the amounts of \$2,365,000 and \$1,739,000, respectively. The revenue is recorded in product revenues in the accompanying condensed consolidated statements of operations. At September 30, 2012 and March 31, 2012, the Company had outstanding accounts receivable of \$375,000 and \$290,000, respectively, related to Innovacyn, Inc.

## Other Matters

On May 21, 2012, the Company received a letter from the Listing Qualifications staff of The NASDAQ Stock Market LLC (“NASDAQ”), notifying the Company that, for the previous 30 consecutive business days, it has failed to comply with NASDAQ Listing Rule 5550(b)(2), which requires the Company to maintain a minimum Market Value of Listed Securities of \$35 million for continued listing on the NASDAQ Capital Market. The letter also noted that the Company did not meet the alternative requirements under Listing Rules 5550(b)(1) or 5550(b)(3).

In accordance with Listing Rule 5810(c)(3)(C), NASDAQ has granted the Company a period of 180 calendar days, or until November 19, 2012, to regain compliance with the Rule. The Company may regain compliance with the Listing Rule at any time during this compliance period if its Market Value of Listed Securities closes at \$35 million or more for a minimum of ten consecutive business days.

The letter has no effect on the listing or trading of the Company’s common stock at this time. However, there can be no assurance that the Company will be able to regain compliance with Listing Rule 5550(b)(2) or the other compliance alternatives under Listing Rule 5550(b). In the event the Company does not regain compliance with the Listing Rule prior to the expiration of the compliance period, it will receive written notification that its securities are subject to delisting, at which time the Company may appeal the delisting determination to a Hearings Panel.

On June 18, 2012, the Company received a letter from the Listing Qualifications staff of NASDAQ, notifying the Company that, for the previous 30 consecutive business days, it has failed to comply with NASDAQ Listing Rule 5550(a)(2), which requires the Company to maintain a minimum bid price of \$1 per share for its common stock.

In accordance with Listing Rule 5810(c)(3)(C), NASDAQ has granted the Company a period of 180 calendar days, or until December 17, 2012, to regain compliance with the Rule. The Company may regain compliance with the Rule at any time during this compliance period if the minimum bid price for its common stock is at least \$1 for a minimum of ten consecutive business days.

The letter has no effect on the listing or trading of the Company’s common stock at this time. However, there can be no assurance that the Company will be able to regain compliance with Listing Rule 5550(a)(2). In the event the Company does not regain compliance with the Listing Rule prior to the expiration of the compliance period, the Company may be eligible for additional time. To qualify, the Company will be required to meet the continued listing requirement for market value of publicly held shares and all other initial listing standards for NASDAQ Capital Market, with the exception of the bid price requirement, and will need to provide written notice of its intention to cure the deficiency during the second compliance period, by effecting a reverse split, if necessary. If the Company meets these requirements, NASDAQ will inform the Company that it has been granted an additional 180 calendar days. However, if it appears to the Staff of NASDAQ that the Company will not be able to cure the deficiency, or if the Company is otherwise not eligible, NASDAQ will provide notice that its securities will be subject to delisting.

## Note 5. Derivative Liabilities

The Company considers financial instruments which do not have fixed settlement provisions to be derivative instruments. The common stock purchase warrants issued with the Company’s August 13, 2007 private placement, and the common stock purchase warrants issued to the placement agent in the transaction, do not have fixed settlement provisions because their exercise prices may be lowered if the Company issues securities at lower prices in the future. The Company was required to include the reset provisions in order to protect the warrant holders from the potential dilution associated with future financings. At issuance, the warrants were recognized as equity instruments and have since been re-characterized as derivative liabilities. Accordingly, the warrant obligations are adjusted to fair value at the end of each reporting period with the change in value reported in the statement of operations. Such fair values were estimated using the Black-Scholes valuation model. Although the Company determined the common stock warrants include an implied down-side protection feature, it performed a Monte-Carlo simulation and concluded that the value of the feature is de minimis between the two models and the use of the Black-Scholes valuation model is considered to be a reasonable method to value the warrants.

The derivative liability related to warrants without fixed settlement provisions were valued using the Black-Scholes option valuation model and the following assumptions on the following dates:

	September 30, 2012	March 31, 2012
Expected life	0.36 years	0.87 years
Risk-free interest rate	0.18%	0.18%
Dividend yield	0.00%	0.00%
Volatility	55%	89%
Warrants outstanding	838,172	762,876
Fair value of warrants	\$ —	\$ 55,000

The Company deems financial instruments which require net-cash settlement as either an asset or a liability. The common stock purchase warrants issued with the Company's April 22, 2012 registered direct offering contain a net-cash settlement feature which gives the warrant holder the right to net-cash settlement in the event certain transactions occur. Pursuant to the terms of the warrants, if such a transaction occurs the warrant holder will be entitled to a net-cash settlement value calculated using the Black-Scholes valuation model using an expected volatility equal to the greater of 100% and the 100 day volatility obtained from the HVT function on Bloomberg, an expected term equal to the remaining term of the warrant, and applicable risk-free interest rate corresponding to the U.S. Treasury. Accordingly, the fair value of the warrant obligation was determined at the date of issuance and was adjusted to fair value at the end of the reporting period using the Black-Scholes valuation model. The change in value reported from issue date to the reporting date was recorded in the accompanying condensed consolidated statement of operations.

The derivative liability related to warrants with net-cash settlement provisions were valued using the Black-Scholes option valuation model and the following assumptions on the following dates:

	<b>September 30, 2012</b>	<b>April 22, 2012</b>
Expected life	2.07 years	2.50 years
Risk-free interest rate	0.41%	0.40%
Dividend yield	0.00%	0.00%
Volatility	100%	100%
Warrants outstanding	3,471,112	3,471,112
Fair value of warrants	\$ 1,552,000	\$ 2,347,000

The Company will continue to adjust the derivative liabilities for changes in fair value until the earlier of the exercise, at which time the liability will be reclassified to stockholders' deficiency, or expiration of the warrants.

The following table sets forth a summary of the changes in the fair value of our Level 3 financial liabilities that are measured at fair value on a recurring basis:

	<b>Three Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>
Beginning balance	\$ (1,155)	\$ (240)
Net unrealized (loss) gain	(397)	121
Ending balance	<u>\$ (1,552)</u>	<u>\$ (119)</u>

	<b>Six Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>
Beginning balance	\$ (55)	\$ (337)
Fair value of warrants issued	(2,347)	-
Net unrealized gain	850	218
Ending balance	<u>\$ (1,552)</u>	<u>\$ (119)</u>

#### **Note 6. Stockholders' Deficiency**

##### ***Registered Direct Offering***

On April 22, 2012, the Company entered into agreements with various investors to issue up to: a) 2,360,001 shares of common stock; b) 1,000 shares of Series A Preferred Stock; and c) warrants to purchase up to 3,471,112 shares of common stock. The Company also offered up to 1,111,111 shares of common stock issuable upon conversion of the Series A Preferred Stock. The Company received approximately \$3,124,000 in gross proceeds from the sale of these securities. Net proceeds after deducting the placement agent commissions, legal expenses and other offering expenses, and assuming no exercise of the warrants, was \$2,832,000. The Company retained Rodman & Renshaw, LLC as the exclusive placement agent for this offering, and paid them \$218,680 in placement agent commissions. Following the close of the transaction, the investor converted 1,000 shares of the Series A Preferred Stock purchased in the transaction into 1,111,111 shares of common stock.

In connection with the convertible preferred stock, the Company determined the instrument contained a beneficial conversion feature at the date of issuance. This beneficial conversion feature amounted to \$1,062,000 and was recorded as a deemed preferred dividend on the condensed consolidated statement of statement of operations for the six months ended September 30, 2012.

The warrants issued with the offering have an initial exercise price of \$1.18 per share, are not exercisable for six months from the date of issuance, and have an exercise term of 2.5 years from the date of issuance. Additionally, the common stock purchase warrants contain a net-cash settlement feature which gives the warrant holder the right to net-cash settlement in the event certain transactions occur. Pursuant to the terms of the warrants, if such a transaction occurs the warrant holder will be entitled to a net-cash settlement value calculated using the Black-Scholes valuation model using specific volatility, expected term and risk-free interest rate assumptions, as detailed in the warrants (Note 5).

#### ***Common Stock Issued to Service Providers***

On April 24, 2009, the Company entered into an agreement with Advocos LLC, a contract sales organization that serves as part of the Company's sales force for the sale of wound care products in the United States. Pursuant to the agreement, the Company agreed to pay the contract sales organization a monthly fee and potential bonuses that will be based on achievement of certain levels of sales. Additionally, the Company agreed to issue the contract sales organization shares of common stock as compensation for its services. The Company has determined that the fair value of the common stock was more readily determinable than the fair value of the services rendered. Accordingly, the Company recorded the fair market value of the stock as compensation expense. During the three months ended September 30, 2012 and 2011, the Company issued 26,096 and 24,587 shares of common stock, respectively, in connection with this agreement. During the three months ended September 30, 2012 and 2011, the Company recorded \$20,000 and \$44,000 of stock compensation expense related to this agreement, respectively. During the six months ended September 30, 2012 and 2011, the Company issued 100,743 and 49,587 shares of common stock, respectively, in connection with this agreement. During the six months ended September 30, 2012 and 2011, the Company recorded \$112,000 and \$92,000 of stock compensation expense related to this agreement, respectively. The expense was recorded as selling, general and administrative expense in the accompanying condensed consolidated statements of operations.

On April 1, 2011, the Company entered into an agreement with NetGain Financial, Inc., for providing financial advisory services. Pursuant to the agreement, the Company agreed to pay NetGain Financial common stock as compensation for services provided. The Company determined that the fair value of the common stock was more readily determinable than the fair value of the services rendered. Accordingly, the Company recorded the fair market value of the stock as compensation expense. During the three months ended September 30, 2012 and 2011, the Company issued 150,000 and 30,000 shares of common stock, respectively, in connection with this agreement. During the three months ended September 30, 2012 and 2011, the Company recorded \$146,000 and \$52,000 of stock compensation expense related to this agreement, respectively. During the six months ended September 30, 2012 and 2011, the Company issued 150,000 and 60,000 shares of common stock, respectively, in connection with this agreement. During the six months ended September 30, 2012 and 2011, the Company recorded \$146,000 and \$110,000 of stock compensation expense related to this agreement, respectively. The expense was recorded as selling, general and administrative expense in the accompanying condensed consolidated statements of operations.

#### ***Anti-dilution Adjustments***

Pursuant to anti-dilution provisions contained in the August 13, 2007 private placement and in the placement agent warrant agreement, for various financing transactions and common stock issuances, the Company is required to adjust the exercise price and the number of warrants held by each warrant holder under these agreements. Over-time, the exercise price for the warrants has been adjusted from the original exercise price of \$9.50 to \$3.75. At September 30, 2012 and March 31, 2012, there were 838,172 and 762,876 warrants outstanding that contain this anti-dilution provision, respectively. During the three months ended September 30, 2012, the Company reduced the exercise price from \$3.76 to \$3.75 and issued an additional aggregate of 2,237 warrants as a result of shares issued to service providers. During the six months ended September 30, 2012, the Company reduced the exercise price from \$4.32 to \$3.75 and issued an additional aggregate of 75,296 warrants as a result of the dilutive effect of the April 22, 2012 registered direct offering and due to shares issued to service providers in a separate transaction. The warrants were classified as derivative liabilities in the September 30, 2012 and March 31, 2012 condensed consolidated balance sheets.

#### **Note 7. Stock-Based Compensation**

The Company accounts for share-based awards exchanged for employee services at the estimated grant date fair value of the award. The Company amortizes the fair value of employee stock options on a straight-line basis over the requisite service period of the awards. Compensation expense includes the impact of an estimate for forfeitures for all stock options. The estimated forfeiture rates used during the six months ended September 30, 2012 ranged from 2.47% to 2.50%.

Employee stock-based compensation expense is as follows (in thousands):

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Cost of service revenue	\$ 34	\$ 31	\$ 66	\$ 50
Research and development	63	76	130	138
Selling, general and administrative	275	262	484	737
Total stock-based compensation	<u>\$ 372</u>	<u>\$ 369</u>	<u>\$ 680</u>	<u>\$ 925</u>

At September 30, 2012, there were unrecognized compensation costs of \$1,681,000 related to stock options which is expected to be recognized over a weighted-average amortization period of 2.09 years.

The Company estimated the fair value of employee stock options using the Black-Scholes option pricing model. The fair value of employee stock options is being amortized on a straight-line basis over the requisite service periods of the respective awards. The fair value of employee stock options was estimated using the following weighted-average assumptions:

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Expected life	5.85 years	6.30 years	5.85 years	5.97 years
Risk-free interest rate	0.73%	1.43%	0.73%	1.52%
Dividend yield	0.00%	0.00%	0.00%	0.00%
Volatility	88%	83%	88%	83%

The weighted-average fair value of options granted during the three and six months ended September 30, 2012 was \$0.68. The weighted-average fair value of options granted during the three and six months ended September 30, 2011 was \$1.02 and \$1.23, respectively.

The expected term of stock options represents the average period the stock options are expected to remain outstanding and is based on the expected term calculated using the approach prescribed by the Securities and Exchange Commission's Staff Accounting Bulletin No. 110 for "plain vanilla" options. The expected stock price volatility for the Company's stock options was determined by examining the historical volatilities for industry peers and using an average of the historical volatilities of the Company's industry peers. The Company will continue to analyze the stock price volatility and expected term assumptions as more data for the Company's common stock and exercise patterns become available. The risk-free interest rate assumption is based on the U.S. Treasury instruments whose term was consistent with the expected term of the Company's stock options. The expected dividend assumption is based on the Company's history and expectation of dividend payouts. The Company estimates forfeitures based on historical experience and reduces compensation expense accordingly.

A summary of all option activity as of September 30, 2012 and changes during the six months then ended is presented below:

<b>Options</b>	<b>Shares (in thousands)</b>	<b>Weighted- Average Exercise Price</b>	<b>Weighted- Average Contractual Term</b>	<b>Aggregate Intrinsic Value (in thousands)</b>
Outstanding at April 1, 2012	6,266	\$ 2.36		
Granted	760	0.94		
Exercised	(39)	0.90		
Forfeited or expired	(72)	5.12		
Outstanding at September 30, 2012	<u>6,915</u>	<u>\$ 2.18</u>	<u>7.20</u>	<u>\$ 214</u>
Exercisable at September 30, 2012	<u>5,260</u>	<u>\$ 2.42</u>	<u>6.75</u>	<u>\$ 233</u>

The aggregate intrinsic value is calculated as the difference between the exercise price of the stock options and the underlying fair value of the Company's common stock (\$0.94) for stock options that were in-the-money as of September 30, 2012.

The Company did not capitalize any cost associated with stock-based compensation.

No income tax benefit has been recognized related to stock-based compensation expense and no tax benefits have been realized from exercised stock options.

The Company issues new shares of common stock upon exercise of stock options.

**Note 8. Income Taxes**

The Company is not aware of any changes in ownership that would result in a change in control under Internal Revenue Code Section 382. The Company, after considering all available evidence, fully reserved for these assets and its other deferred tax assets since it is more likely than not such benefits will not be realized in future periods. The Company has incurred losses for both financial reporting and income tax purposes for the year ended March 31, 2012. Accordingly, the Company is continuing to fully reserve for its deferred tax assets. The Company will continue to evaluate its deferred tax assets to determine whether any changes in circumstances could affect the realization of their future benefit. If it is determined in future periods that portions of the Company's deferred income tax assets satisfy the realization standards, the valuation allowance will be reduced accordingly.

As a result of certain realization requirements of the Company's deferred tax assets and liabilities do not include certain deferred tax assets at September 30, 2012 that arose directly from tax deductions related to equity compensation in excess of compensation recognized for financial reporting purposes. Equity will be increased by approximately \$533,000 if and when such deferred tax assets are ultimately realized.

The Company only recognizes tax benefits from an uncertain tax position if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. To date, the Company has not recognized such tax benefits in its financial statements.

The Company has identified its federal tax return and its state tax return in California as major tax jurisdictions. The Company also filed tax returns in foreign jurisdictions, principally Mexico and The Netherlands. The Company's evaluation of uncertain tax matters was performed for tax years ended through March 31, 2012. Generally, the Company is subject to audit for the years ended March 31, 2011, 2010 and 2009 and may be subject to audit for amounts relating to net operating loss carryforwards generated in periods prior to March 31, 2009. The Company has elected to retain its existing accounting policy with respect to the treatment of interest and penalties attributable to income taxes, and continues to reflect interest and penalties attributable to income taxes, to the extent they arise, as a component of its income tax provision or benefit as well as its outstanding income tax assets and liabilities. The Company believes that its income tax positions and deductions would be sustained on audit and does not anticipate any adjustments, other than those identified above that would result in a material change to its financial position.

**Note 9. Segment and Geographic Information**

The Company generates revenues from wound care products which are sold into the human and animal health care markets and the Company also generates revenues from laboratory testing services which are provided to medical device manufacturers. The Company operates a single segment business which consists of three geographical sales territories as follows (in thousands):

	<b>Three Months Ended September 30,</b>		<b>Six Months Ended September 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
U.S.	\$ 1,898,000	\$ 1,446,000	\$ 3,931,000	\$ 2,286,000
Mexico	1,862,000	1,304,000	3,240,000	2,684,000
Europe and Other	504,000	640,000	909,000	1,130,000
	<u>\$ 4,264,000</u>	<u>\$ 3,390,000</u>	<u>\$ 8,080,000</u>	<u>\$ 6,100,000</u>

For the three months ended September 30, 2012 and 2011, the Company received licensing revenues of \$374,000 and \$94,000, respectively. Such revenues are included in the Company's calculation of product revenues and are reflected in the table above under the respective geographic region where such licensing revenues were earned. For the six months ended September 30, 2012 and 2011, the Company received licensing revenues of \$406,000 and \$189,000, respectively. Such revenues are included in the Company's calculation of product revenues and are reflected in the table above under the respective geographic region where such licensing revenues were earned.

The Company's service revenues amounted to \$262,000 and \$273,000 for the three months ended September 30, 2012 and 2011, respectively, and the Company's service revenues amounted to \$497,000 and \$503,000 for the six months ended September 30, 2012 and 2011, respectively.



## **Note 10. Significant Customer Concentrations**

For the three months ended September 30, 2012, one customer represented 27% of net revenue, and for the three months ended September 30, 2011, one customer represented 32% of net revenue.

For the six months ended September 30, 2012, one customer represented 28% of net revenue, and for the six months ended September 30, 2011, one customer represented 26% of net revenue.

At September 30, 2012, one customer represented 11%, one customer represented 13%, and one customer represented 16% of the net accounts receivable balance. At March 31, 2012, one customer represented 13% and two customers each, respectively, represented 12% of the net accounts receivable balance.

## **Note 11. Subsequent Events**

### *Property Lease Agreements*

On October 10, 2012, the Company entered into Amendment No. 7 to its property lease agreement, extending the lease on its Petaluma, California facility to September 30, 2017. Pursuant to the amendment, in exchange for certain improvements on the building, the Company agreed to increase the lease payment from \$10,380 to \$11,072 per month.

The Company has also entered into a property lease agreement for two properties in Sacramento, California:

- 3045 65th Street, Suite 13, Sacramento, CA 95820
- 3021 65th Street, Sacramento, CA 95820

On August 30, 2012, the Company entered into an amendment to its lease dated October 31, 2011 for the property located at 3045 65th Street, Suite 13, Sacramento, California 95820, to amend the lease to include a 3,000 square foot industrial unit located at 3021 65th Street, Sacramento, California, and to extend the lease on both properties to October 31, 2013. The total rent for both properties is \$2,610 per month.

### *Agreement to Extend the Expiration Date of Warrants in Exchange for the Removal of Certain Settlement Features in Those Warrants*

On October 29, 2012, the Company entered into a side letter agreement with Sabby Healthcare Volatility Master Fund, Ltd. and Sabby Volatility Warrant Master Fund, Ltd. (collectively, "Sabby") to amend the terms of the warrants issued to Sabby in conjunction with the Company's April 22, 2012 registered direct offering. Pursuant to the amendment, Sabby agreed to waive certain net-cash settlement features contained in the warrants in exchange for the Company's agreement to a two-year extension of the expiration date of the warrants. Accordingly, the expiration date of the warrants issued to Sabby in connection with the April 22, 2012 financing was extended from October 25, 2014 to October 25, 2016. No other terms, rights or provisions of the purchase agreement or warrants were modified by the terms of the side letter agreement.

### *Restructuring of Debt for Shares of the Company's Common Stock*

On May 1, 2010, the Company entered into a loan and security agreement and a supplement to the loan and security agreement with Venture Lending & Leasing V, Inc., to borrow up to an aggregate of \$3,000,000. In connection with those agreements, the Company issued two warrants to Venture Lending & Leasing V, LLC, a Delaware limited liability company ("LLC5"), which, in the aggregate, have a total put option cash value of \$750,000 (the "VLL5 Warrants").

On June 29, 2011, the Company entered into a loan and security agreement and a supplement to the loan and security agreement with Venture Lending & Leasing VI, Inc., to borrow up to an aggregate of up to \$2,500,000. In connection with those agreements, the Company issued three warrants to Venture Lending & Leasing VI, LLC, a Delaware limited liability company ("LLC6"), which, in the aggregate, have a total put option cash value of \$1,250,000 (the "VLL6 Warrants").

On October 30, 2012, the Company entered into a stock purchase agreement with LLC5 and LLC6 for the issuance to LLC5 and LLC6 of shares of common stock having an aggregate fair market value equal to \$3,500,000, in exchange for LLC5's agreement to surrender the VLL5 Warrants and LLC6's agreement to surrender the VLL6 Warrants. The number of shares issued pursuant to the stock purchase agreement was calculated based upon a price of \$0.810 per share, the consolidated closing bid price as reported by The NASDAQ Capital Market for October 26, 2012, the previous trading day's consolidated closing bid price. Accordingly, on November 1, 2012, the Company issued an aggregate of 4,320,985 restricted shares of common stock to LLC5 and LLC6, pursuant to the terms of the stock purchase agreement.

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

*The following discussion of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and notes to those statements included elsewhere in this Quarterly Report on Form 10-Q as of September 30, 2012 and our audited consolidated financial statements for the year ended March 31, 2012 included in our Annual Report on Form 10-K, filed with the Securities and Exchange Commission on June 21, 2012.*

*This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. When used in this report, the words “expects,” “anticipates,” “suggests,” “believes,” “intends,” “estimates,” “plans,” “projects,” “continue,” “ongoing,” “potential,” “expect,” “predict,” “believe,” “intend,” “may,” “will,” “should,” “could,” “would” and similar expressions are intended to identify forward-looking statements.*

*Forward-looking statements are subject to risks and uncertainties that could cause our actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to the risks described in our Annual Report on Form 10-K including: our ability to become profitable; the effect of the general decline in the economy on our business; the progress and timing of our development programs and regulatory approvals for our products; the benefits and effectiveness of our products; the ability of our products to meet existing or future regulatory standards; the progress and timing of clinical trials and physician studies; our expectations related to the use of our cash reserves; our expectations and capabilities relating to the sales and marketing of our current products and our product candidates; our ability to gain sufficient reimbursement from third-party payors; our ability to compete with other companies that are developing or selling products that are competitive with our products; the establishment of strategic partnerships for the development or sale of products; the risk our research and development efforts do not lead to new products; the timing of commercializing our products; our ability to penetrate markets through our sales force, distribution network, and strategic business partners to gain a foothold in the market and generate attractive margins; the expansion of our sales force and distribution network; the ability to attain specified revenue goals within a specified time frame, if at all, or to reduce costs; the outcome of discussions with the U.S. Food and Drug Administration, or FDA, and other regulatory agencies; the content and timing of submissions to, and decisions made by, the FDA and other regulatory agencies, including demonstrating to the satisfaction of the FDA the safety and efficacy of our products; our ability to manufacture sufficient amounts of our product candidates for clinical trials and products for commercialization activities; our ability to protect our intellectual property and operate our business without infringing on the intellectual property of others; our ability to continue to expand our intellectual property portfolio; our expectations about the outcome of litigation and controversies with third parties; the risk we may need to indemnify our distributors or other third parties; our ability to attract and retain qualified directors, officers and employees; our expectations relating to the concentration of our revenue from international sales; our ability to expand to and commercialize products in markets outside the wound care market; and the impact of the Sarbanes-Oxley Act of 2002 and any future changes in accounting regulations or practices in general with respect to public companies. These forward-looking statements speak only as of the date hereof. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based, except as required by law.*

### **Our Business**

We are a commercial healthcare company that designs, produces, and markets innovative, safe and effective drugs, devices, and nutritional products. We are pioneering innovative products for the dermatology, surgical, wound care, and animal healthcare markets. Our primary focus is on our proprietary technology platform called Microcyn® Technology. This technology is based on electrically charged oxychlorine small molecules designed to target a wide range of organisms that cause disease (pathogens). These include viruses, fungi, spores and antibiotic-resistant strains of bacteria, such as methicillin-resistant *Staphylococcus aureus*, or MRSA, and vancomycin-resistant *Enterococcus*, or VRE, in wounds, as well as *Clostridium difficile*, or C. diff, a highly contagious bacteria spread by human contact. Several Microcyn® Technology tissue care products are designed to treat infections and enhance healing while reducing the need for antibiotics. Infection is a serious potential complication in both chronic and acute wounds, and controlling infection is a critical step in wound healing.

We do not have the necessary regulatory approvals to market Microcyn® as a drug or as a medical device with an antimicrobial or wound healing indication in the United States. In the future, we expect to apply with the U.S. Food and Drug Administration, or FDA, for clearance as an antimicrobial in a liquid and a hydrogel form.

Outside the United States, our Microcyn® Technology products have a CE Mark device approval in Europe for debriding, irrigating and moistening acute and chronic wounds in comprehensive wound treatment by reducing microbial load and creating a moist environment. In Mexico, we are approved as a drug for antiseptic treatment of wounds and infected areas. In India, our technology has a drug license for cleaning and debriding in wound management. In China, we have obtained a medical device approval by the State Food and Drug Administration for reducing the propagation of microbes in wounds and creating a moist environment for wound healing.

While we do not have the necessary regulatory clearance for an antimicrobial or wound healing indication in the United States, several factors including global product experience, clinical and laboratory testing, physician-led clinical studies based on our technology, and scientific papers authored on our technology, suggest that our Microcyn® Technology may help reduce a wide range of pathogens from acute and chronic wounds while curing or improving infection and concurrently enhancing wound healing through modes of action unrelated to the treatment of infection. These physician-led clinical studies suggest that our Microcyn® Technology is safe, easy to use and complementary to many existing treatment methods in wound care. Physician-led clinical studies and usage in the United States suggest that our 510(k) cleared products may shorten hospital stays, lower aggregate patient care costs and, in certain cases, reduce the need for systemic antibiotics. We are also pursuing the use of our Microcyn® Technology platform in other markets outside of wound and skin care, including the respiratory, ophthalmology, dental, dermatology, animal healthcare and industrial markets.

Common methods of controlling infection, including topical antiseptics and antibiotics, have proven to be only moderately effective in combating infection in the wound bed. However, topical antiseptics tend to inhibit the healing process due to their toxicity and may require specialized preparation or handling. Antibiotics can lead to the emergence of resistant bacteria, such as MRSA and VRE. Systemic antibiotics may be less effective in controlling infection in patients with disorders affecting circulation, such as diabetes, which are commonly associated with chronic wounds. As a result, no single treatment is used across all types of wounds and stages of healing and we believe Microcyn® Technology can fill a niche in the chronic and acute wound care markets.

We believe Microcyn® Technology is a stable, anti-infective therapeutic that treats infections and enhances wound healing through increased blood flow to the wound bed and reduction of chronic inflammation. Also, we believe Microcyn® Technology provides significant advantages over current methods of care in the treatment of a wide range of chronic and acute wounds throughout all stages of treatment. These stages include cleaning, debridement, prevention and treatment of infections and wound healing. We believe that unlike antibiotics, antiseptics, growth regulators and other advanced wound care products, Microcyn® Technology is a stable wound care solution that is as safe as saline, and also treats infection while simultaneously accelerating wound healing. Also, unlike most antibiotics, we believe Microcyn® Technology does not target specific strains of bacteria, a practice which has been shown to promote the development of resistant bacteria. In addition, our products are shelf stable, non-toxic, require no special preparation and are easy to use.

Our goal is to become a worldwide leader as the standard of care in the treatment and irrigation of open wounds and skin care. We currently have, and intend to seek additional, regulatory clearances and approvals to market our Microcyn-based products worldwide. In July 2004, we began selling Microdacyn60™ in Mexico after receiving approval from the Mexican Ministry of Health, for use as an antiseptic, disinfectant and sterilant. Since then, physicians and scientists in the United States, Europe, India, Pakistan, China and Mexico have conducted more than 40 clinical and scientific studies of Microcyn® Technology, generating data suggesting that the technology is non-irritating to healthy tissue, reduces microbial load, accelerates wound healing, reduces pain, shortens treatment time and may have the potential to reduce costs to healthcare providers and patients. Most of these studies were not intended to be rigorously designed or controlled clinical trials and, as such, did not have all of the controls required for clinical trials used to support a new drug application submission to the FDA. A number of these studies did not include blinding, randomization, predefined clinical end points, use of placebo and active control groups or U.S. Good Clinical Practice (GCP) requirements. We used the data generated from some of these studies to support our application for the CE Mark, the European Union certification, for wound cleaning and reduction of microbial load. We received the CE Mark in November 2004 and additional international approvals in China, Canada, Mexico and India. To date, our Microcyn-based products have received seven FDA 510(k) clearances. Many of these clearances are for use as a medical device in wound cleaning, or debridement, lubricating, moistening and dressing, including traumatic wounds and acute and chronic dermal lesions.

In December 2011, we initiated a voluntary recall of select lot numbers of certain of our Microcyn-based products due to product labeling. The voluntary recall was prompted after notification by the FDA that a limited number of our products were improperly labeled. The recall has been classified by the FDA as a Class II recall, which means the probability of serious health consequences is remote. Customer safety and product quality are critically important to us and to date, we have received no complaints regarding customer safety or product quality issues. The costs of the voluntary recall were nominal and there were no restrictions on our future sales of Microcyn-based products, other than revising our product labeling for certain products. The voluntary recall did not materially impact revenues.

## **Sales and Marketing**

In the quarter ending December 31, 2008, our initial sales were in the podiatry market in the United States. In the second quarter of 2009, we expanded our sales efforts to include wound care centers, hospitals, nursing homes, urgent care clinics and home healthcare, utilizing a contract sales organization to aid our sales force. We continue to seek opportunities to expand the applicability of our products. Our products are purchased by, among others, hospitals, physicians, nurses, and other healthcare practitioners who are the primary caregivers to patients being treated for acute or chronic wounds or undergoing surgical procedures as well as to dermatologists for treatment of various skin afflictions.

We currently make Microcyn-based human wound and skin care products available, both as prescription and over-the-counter products, under our seven 510(k) clearances in the United States, primarily through a combination of partnerships with Advocos LLC, a specialty U.S. contract sales organization, and with such partners as Amneal Enterprises, PreCision Dermatology and Eloquest Healthcare, Inc., a subsidiary of Ferndale Pharma, Inc., described in greater detail below. Specifically, we have announced the commercialization of a Microcyn® product for wound care sold through a combination of contract and commissioned sales forces and by Eloquest Healthcare, and the commercialization of Microcyn® products for dermatology through partnerships with Quinnova Pharmaceuticals and PreCision Dermatology.

Additionally, through our partner Innovacyn, Inc., we currently make available Microcyn® Technology-based animal healthcare products branded as Vetericyn in the United States and Europe. We plan to introduce these products into Canada and Innovacyn has received approval from Health Canada to begin marketing our products in their country. In the future, we plan to expand the sales and marketing of our Microcyn® Technology-based animal healthcare products to Asia.

We intend to pursue additional regulatory approvals in Europe, China, India and Mexico for our Microcyn® Technology tissue care products and plan to initiate commercialization upon obtaining these approvals.

#### *Animal Healthcare*

On January 26, 2009, we entered into a commercial agreement with VetCure, Inc., a California corporation, to market and sell our Vetericyn products. VetCure, Inc. later changed its name to Vetericyn, Inc., which, at the time, was wholly owned by Mr. Robert Burlingame. This agreement was amended on February 24, 2009, July 24, 2009, June 1, 2010, and November 1, 2010. Pursuant to the agreement, we provide Vetericyn, Inc. with bulk product and Vetericyn, Inc. bottles, packages, and sells Vetericyn products. We receive a fixed amount for each bottle of Vetericyn sold by Vetericyn, Inc. At the time of each of these 2009 transactions, Vetericyn was wholly owned by Mr. Burlingame, who was also our Director at that time. Mr. Burlingame resigned from our Board on February 10, 2010. After his resignation, Mr. Burlingame continued to own a significant portion of our stock from a transaction with us in 2009. To our knowledge, he ceased being a holder of more than 5% of our common stock in 2010.

On September 15, 2009, we entered a commercial agreement with V&M Industries, Inc., a California corporation, to market and sell our Microcyn over-the-counter liquid and gel products. V&M Industries, Inc. subsequently changed their name to Innovacyn, Inc. On June 1, 2010, September 1, 2010, and November 1, 2010, we amended this agreement granting Innovacyn, Inc. the exclusive right to sell certain of our over-the-counter products. On May 13, 2010, Innovacyn received confirmation from Health Canada that it has approval to market these veterinary products in the Canadian market as well. At the time of the 2009 transaction, V&M Industries, Inc. was wholly owned by Robert Burlingame, who was also our Director at that time. Mr. Burlingame resigned from our Board on February 10, 2010. After his resignation, Mr. Burlingame continued to own a significant portion of our stock from a transaction with us in 2009. To our knowledge, he ceased being a holder of more than 5% of our common stock in 2010.

Additionally, beginning on July 1, 2011, Vetericyn, Inc. and Innovacyn, Inc. share profits with us related to the Vetericyn and Microcyn over-the-counter sales, resulting in about a 30% royalty of net revenue.

#### *Acute Care in U.S. Hospitals*

On August 1, 2011, we entered into a multi-year licensing agreement with Eloquest Healthcare, Inc., a subsidiary of Ferndale Pharma Group, Inc. Under this agreement, we granted Eloquest Healthcare an exclusive license to market certain Microcyn-based wound care products under the Eloquest Healthcare brand to hospitals, ambulatory surgical and acute care centers in the United States. In March 2012, Ferndale/ Eloquest launched a family of Microcyn-based wound care products.

#### *Critical Care*

On August 22, 2011, we entered into an agreement to license the exclusive global rights to a unique endotracheal tube, or ETT, from the National Institutes of Health. We believe the ETT represents a potential breakthrough technology in mitigating ventilator-associated pneumonia. Under the licensing agreement, we agreed to pay a nonrefundable royalty of \$20,000 within sixty days of the effective date of the agreement, minimum annual royalties of \$5,000, and additional royalties based off of net sales from use of the license. The patent term of the ETT expires on March 15, 2025. The ETT requires a device clearance in the United States and we expect to obtain such clearance in the near future.

#### *Dermatology*

On November 8, 2010, we announced a definitive agreement with Onset Therapeutics, now called PreCision Dermatology, Inc. Under this agreement, PreCision Dermatology combined our Microcyn® hydrogel with its new skin barrier product into a prescription convenience kit. The kit was launched in the first quarter of 2011 and sales are targeted toward patients with atopic dermatitis and related conditions. PreCision Dermatology has a sales force of about 35 people whom market a complete line of dermatology products throughout the United States.

On February 14, 2011, we announced the formation of a broad multi-year collaboration with Amneal Enterprises to realize the development and commercial potential of Microcyn® Technology. Amneal Enterprises is an affiliation of independent pharmaceutical marketing, discovery and development companies. As a part of this collaboration, Quinnova Pharmaceuticals, Inc., an Amneal alliance member, has licensed, with a \$500,000 prepayment and ongoing double-digit royalties, the U.S. and Canadian rights to the Microcyn-based dermatology atopic dermatitis hydrogel that received FDA clearance in February 2011. Future prescription dermatology products can also be licensed for undisclosed upfront payments. In addition, Quinnova agreed to co-promote the current prescription Microcyn-based wound care products to podiatry professionals in the United States and Canada. Quinnova has a sales force of over 35 people, selling to dermatologists and podiatrists with a complete line of dermatology products. In addition, Quinnova launched the Atrapro™ family of products formulated from Microcyn® Technology platform in late February 2012.

Additionally, we sold the option to exclusively sell and distribute our proprietary Microcyn-based acne drug candidate to AmDerma Pharmaceuticals, LLC, an Amneal alliance member, for a one-time non-refundable payment of \$500,000. On June 23, 2011, AmDerma exercised its option to license rights to the drug candidate. On June 21, 2012, we entered into a collaboration agreement with AmDerma. Pursuant to the agreement, AmDerma is responsible for the development of a Microcyn-based acne drug candidate in the United States, including all activities required to gain regulatory approvals. AmDerma will also be responsible for all costs. Additionally, within one year of the first commercial sale by AmDerma, AmDerma shall identify at least one secondary indication that AmDerma will develop. If AmDerma declines to pursue such secondary indication, then the right to develop such secondary indication will revert back to us. We granted AmDerma an exclusive, royalty-bearing perpetual license in the United States and India, with the right to sublicense and subcontract in certain circumstances, and a right of first refusal to expand the territory of the license to include the European Union, Canada, Brazil, and Japan. We retained rights to the “rest of world.” The option payment of \$500,000 will be credited against future milestone payments in the transaction.

### **International Sales and Marketing by Our Strategic Business Partners**

#### *Europe*

We currently rely on exclusive agreements with country-specific distributors for the sale of Microcyn-based products in Europe, including in Italy, the Netherlands, Germany, Czech Republic, Sweden, Finland and Denmark.

#### *People’s Republic of China*

On January 28, 2011, we entered into an agreement with Tianjin Ascent Import and Export Company, Ltd., a distributor in China, to sell certain of our liquid products, which are currently sold under the product name “Microcyn” in the United States, into the People’s Republic of China. Pursuant to the agreement, we received a \$350,000 non-refundable upfront payment from the distributor in return for exclusivity to sell these liquid products for the first contract year. In order to maintain exclusivity in subsequent years, the distributor will need to meet minimum purchase requirements each contract year. The initial term of the contract is for five years and is cancellable if certain conditions are not met.

On June 26, 2011, we entered into an agreement with Shanghai Sunvic Technology Co. Ltd., a distributor in China, to sell certain of our gel products, which are currently sold under the product name “Microcyn” in the United States, into the People’s Republic of China. The initial term of the contract is for five years and is cancellable if certain conditions are not met.

#### *Mexico*

On August 9, 2012, we, along with our Mexican subsidiary and manufacturer Oculus Technologies of Mexico S.A. de C.V. (“Manufacturer”), entered into a license, exclusive distribution and supply agreement with More Pharma Corporation, S. de R.L. de C.V. (“More Pharma”) (the “License Agreement”). For a one-time payment of \$500,000, we granted More Pharma an exclusive license, with the right to sublicense under certain conditions and with our consent, to all of our proprietary rights related to certain of our pharmaceutical products for human application that utilize our Microcyn Technology within Mexico. For an additional one-time payment of \$3,000,000, we also agreed to appoint More Pharma as the exclusive distributor of certain of our products in Mexico for the term of the agreement. Additionally, Manufacturer granted More Pharma an exclusive license to certain of Manufacturer’s then-held trademarks in exchange for a payment of \$100,000 to Manufacturer. The term of the agreement is twenty-five years from the effective date of August 15, 2012 (the “Effective Date”). The term of the License Agreement will automatically renew after the twenty-five year term for successive two year terms as long as More Pharma has materially complied with any and all of the obligations under the License Agreement, including but not limited to, meeting the minimum purchase requirements set forth therein.

On August 9, 2012, we, along with Manufacturer, also entered into an exclusive distribution and supply agreement with More Pharma (the “Distribution Agreement”). For a one-time payment of \$1,500,000, we granted More Pharma exclusive ability to market and sell certain of our pharmaceutical products for human application that utilize our Microcyn Technology. We also appointed More Pharma as our exclusive distributor, with the right to execute sub-distribution agreements under certain conditions and with our consent, within the following countries: Antigua & Barbuda, Argentina, Aruba & Curacao, Bahamas, Barbados, Belize, Bolivia, Bonaire, Brazil, British Guyana, British Islands, Cayman Islands, Chile, Colombia, Cuba, Dominica, Dominican Republic, Ecuador, El Salvador, French Guyana, Grenada, Guadalupe, Guatemala, Haiti, Honduras, Jamaica, Martinique, Nicaragua, Paraguay, Peru, St. Bartolome, St. Vincent & Grenades, Surinam, Trinidad & Tobago, Turks & Caicos Islands, Uruguay, Venezuela and Virgin Islands (the “Territory”).

#### *“Rest of World”*

In India, we entered into an exclusive agreement with Alkem Laboratories, a large pharmaceutical company in India, for the sale of Microcyn-based products in India and Nepal.

Throughout the rest of the world, we intend to use strategic partners and distributors who have a significant sales, marketing and distribution presence in their respective countries. We have established partners and distribution channels for our wound care products in Bangladesh, Pakistan, Singapore, United Arab Emirates and Saudi Arabia.

### **Nutritional Products**

We established a nutritional products division under the name Napa Valley Nutritionals, in the beginning of 2012 to expand our product pipeline. Under this division based out of Sacramento, California, we aim to develop and manufacture medical foods that combine the best of science and nature to create products which provide patients with natural healthcare therapies with a particular focus on the development of products to assist diabetics.

We launched our first nutritional product in April 2012, Glucorein<sup>TM</sup> Green Tea with chlorogenic acid, a medical food intended for the dietary management of glucose levels in both pre-diabetics and type 2 diabetics under the supervision of a medical professional. Our product is currently being test-marketed in the United States and by medical professionals. Primary marketing efforts for our nutritional products are directed toward securing the recommendation of our Napa Valley Nutritional brand of products by physicians or other health care professionals.

Competition for nutritional products in the segment is generally from other consumer and healthcare manufacturers. Competitive factors include consumer advertising, formulation, packaging, scientific innovation, intellectual property, price, and availability of product forms. A significant aspect of competition is the search for ingredient innovations. The introduction of new products by competitors, changes in medical practices and procedures, and regulatory changes can result in product obsolescence. In addition, private label and local manufacturers' products may increase competitive pressure.

### **Contract Testing**

We also operate a microbiology contract testing laboratory division that provides consulting and laboratory services to medical companies that design and manufacture biomedical devices and drugs, as well as testing on our products and potential products. Our testing laboratory complies with U.S. Current Good Manufacturing Practices (CGMPs) and Quality Systems Regulations.

### **Comparison of Three Months Ended September 30, 2012 and 2011**

#### ***Revenues***

Total revenues were \$4,526,000 for the three months ended September 30, 2012 compared to \$3,663,000 in the quarter ended September 30, 2011. Product revenues increased \$874,000, or 26%, with increases in the United States, Mexico and Singapore, partially offset by declines in Europe, India and China.

Product revenue in the United States increased \$452,000, or 31%, due to both unit growth and new product launches into the dermatology market, and higher unit growth and royalty fees received from our partner Innovacyn, Inc. Effective July 1, 2011, the royalty rate we receive from Innovacyn increased from approximately 19% to approximately 30%. We recorded revenue in the amounts of \$1,229,000 and \$1,176,000 for the three months ended September 30, 2012 and 2011, respectively, from Innovacyn. Revenue growth attributed to our dermatology partners reflects strong unit growth as three new product lines were launched in the fourth quarter of the fiscal year ended March 31, 2012. Furthermore, we recognized deferred upfront fees of \$154,000 related to the termination of our agreement with Union Springs Pharmaceuticals.

Revenue in Mexico for the three months ended September 30, 2012 increased \$558,000, or 43%, when compared to the same period in the prior year. The increase was driven by a 14% increase in sales of our 120 ml, 240 ml and gel presentations and a 67% increase in sales of our 5 liter presentation and the recognition of \$183,000 related to the amortization of upfront fees paid by More Pharma Corporation, S. de R.L. de C.V., our new exclusive distributor in Mexico. The effective date of our entry into the distribution agreement with More Pharma was August 15, 2012. Accordingly, as a result of this agreement, revenues recognized during approximately the first half of the quarter ended September 30, 2012 were accounted for as we had traditionally reported in the past with the sales sold to the end customer. However, during approximately the second half of the quarter ended September 30, 2012, we recognized revenue on the sell through basis for the products More Pharma purchased from us. The pricing of the units sold to More Pharma is based on fixed prices, which is about 55% on average of the current market price. Also, due to the transfer of the sales function of our products in Mexico to More Pharma, we reduced or transferred the cost of the sales people and promotions and thus, eliminated those certain operating costs. During the quarter ended September 30, 2012, we incurred about \$410,000 of severance and related one-time costs in connection with the transfer of our sales function of our products in Mexico to More Pharma. In addition, an upfront fee of \$5,100,000 will be recognized as revenue over a three to five year period, and such determination is based on the term of the agreements with More Pharma and an analysis of our experience with similar transactions.

Revenue in Europe and Rest of World for the three months ended September 30, 2012 decreased \$136,000, or 21%, as compared to the same period in the prior year, primarily as the result of decreases in sales in Europe, India, Middle East and China, partially offset by increases in Singapore.

The following table shows our product revenues by geographic region:

	<b>Three Months Ended September 30,</b>			
	<b>2012</b>	<b>2011</b>	<b>\$ Change</b>	<b>% Change</b>
United States	\$ 1,898,000	\$ 1,446,000	\$ 452,000	31%
Mexico	1,862,000	1,304,000	558,000	43%
Europe and Rest of World	504,000	640,000	(136,000)	(21)%
Total	<u>\$ 4,264,000</u>	<u>\$ 3,390,000</u>	<u>\$ 874,000</u>	<u>26%</u>

Licensing revenues of \$374,000 and \$94,000, respectively, are also included in our calculation of product revenues for the quarters ended September 30, 2012 and 2011 and are reflected in the table above under the respective geographic region where such licensing revenues were earned.

Service revenues decreased \$11,000 when compared to the same period in the prior year due to a decrease in the number of tests provided by our services business.

### ***Gross Profit***

We reported gross profit related to our Microcyn® products of \$3,172,000 or 74% of product revenues, during the three months ended September 30, 2012, compared to a gross profit of \$2,722,000, or 80% of product revenues, for the same period in the prior year. Our lower percentage of gross profitability is primarily the result of product mix in the United States and the impact of the execution of the More Pharma transaction in Mexico. Our margins in Mexico were 74% of product revenues during the three months ended September 30, 2012, compared to 81% for the same period in the prior year.

### ***Research and Development Expense***

Research and development expense decreased \$47,000, or 8%, to \$513,000 for the three months ended September 30, 2012, compared to \$560,000 for the same period in the prior year due to decreased tests and studies conducted during the three months ended September 30, 2012.

We expect that our research and development expense will increase slightly over the next few quarters as we incur additional expenses related to laboratory tests, clinical trials and the development and approval of new products.

### ***Selling, General and Administrative Expense***

Selling, general and administrative expense increased \$656,000, or 23%, to \$3,504,000 during the three months ended September 30, 2012, as compared to \$2,848,000 for the same period in the prior year. The increase for the three months ended September 30, 2012 was primarily due to \$410,000 of one-time severance costs in Mexico and higher expenses related to new products, compensation, and investor-related costs in the United States.

We expect selling, general and administrative expenses to decline in the next period as we see the impact of lower sales-related expenses in Mexico.

### ***Interest Expense and Interest Income***

Interest expense increased \$50,000 during the three months ended September 30, 2012 as compared to the same period of the prior year. The increase relates to an additional \$14,000 of cash interest incurred and an additional \$36,000 of non-cash interest incurred during the three months ended September 30, 2012. The cash and non-cash interest is related to borrowings from Venture Lending & Leasing V, Inc. and Venture Lending & Leasing VI, Inc. Interest income for the three months ended September 30, 2012 showed no material change from the same period of the prior year.

### ***Other Expense, Net***

Other expense, net decreased \$75,000 to \$26,000 for the three months ended September 30, 2012, compared to other expense, net of \$101,000 for the same period in the prior year. The change in other expense, net for the three months ended September 30, 2012 was primarily related to unrealized foreign exchange gains and losses on intercompany transactions and tax accruals.

### ***Derivative Liabilities***

During the three months ended September 30, 2012, we recorded a decrease in the fair value of our derivative liabilities of \$397,000 and as a result, we recorded this amount as a non-cash loss. For the three months ended September 30, 2011, we recorded a non-cash gain of \$121,000. The change in the fair value of our derivative liabilities for the three months ended September 30, 2012 was primarily the result of increases in our stock price.

### ***Net (Loss)***

Net loss for the three months ended September 30, 2012 was \$1,519,000, an increase of \$680,000, as compared to a net loss of \$839,000 for the same period in the prior year.

## **Comparison of Six Months Ended September 30, 2012 and 2011**

### ***Revenues***

Total revenues were \$8,577,000 for the six months ended September 30, 2012 compared to \$6,603,000 in the six months ended September 30, 2011. Product revenues increased \$1,980,000, or 32%, with increases in the United States, Mexico and Singapore, offset by a decline in Europe, India and China.

Product revenue in the United States increased \$1,645,000, or 72%, due to both unit growth and new product launches into the dermatology market, and higher unit growth and royalty fees received from our partner Innovacyn, Inc. Effective July 1, 2011, the royalty rate we receive from Innovacyn increased from approximately 19% to approximately 30%. We recorded revenue in the amounts of \$2,365,000 and \$1,739,000, respectively, for the six months ended September 30, 2012 and 2011, from Innovacyn. Revenue growth attributed to our dermatology partners reflects strong unit growth as three new product lines were launched in the fourth quarter of the fiscal year ended March 31, 2012. Furthermore, we recognized deferred upfront fees of \$154,000 related to the termination of our agreement with Union Springs Pharmaceuticals.

Revenue in Mexico for the six months ended September 30, 2012, increased \$556,000, or 21%, when compared to the same period in the prior year. The increase was driven by a 15% increase in sales of our 120 ml, 240 ml and gel presentations and a 67% increase in sales of our 5 liter presentation and the recognition of \$183,000 related to the amortization of upfront fees paid by More Pharma Corporation, S. de R.L. de C.V., our new exclusive distributor in Mexico. The effective date of our entry into the distribution agreement with More Pharma was August 15, 2012. Accordingly, as a result of this agreement, revenues recognized during approximately the first half of the quarter ended September 30, 2012 were accounted for as we had traditionally reported in the past with the sales sold to the end customer. However, during approximately the second half of the quarter ended September 30, 2012, we recognized revenue on the sell through basis for the products More Pharma purchased from us. The pricing of the units sold to More Pharma is based on fixed prices, which is about 55% on average of the current market price. Also, due to the transfer of the sales function of our products in Mexico to More Pharma, we reduced or transferred the cost of the sales people and promotions and thus, eliminated those certain operating costs. During the six months ended September 30, 2012, we incurred about \$410,000 of severance and related one-time costs in connection with the transfer of our sales function of our products in Mexico to More Pharma. In addition, an upfront fee of \$5,100,000 will be recognized as revenue over a three to five year period, and such determination is based on the term of the agreements with More Pharma and an analysis of our experience with similar transactions.

Revenue in Europe and Rest of World for the six months ended September 30, 2012 decreased \$221,000, or 20%, as compared to same period in the prior year, primarily as the result of decreases in sales in Europe, India, Middle East and China, partially offset by increases in Singapore.



The following table shows our product revenues by geographic region:

	<b>Six Months</b>		<b>\$ Change</b>	<b>% Change</b>
	<b>Ended September 30,</b>			
	<b>2012</b>	<b>2011</b>		
United States	\$ 3,931,000	\$ 2,286,000	\$ 1,645,000	72%
Mexico	3,240,000	2,684,000	556,000	21%
Europe and Rest of World	909,000	1,130,000	(221,000)	(20)%
<b>Total</b>	<b>\$ 8,080,000</b>	<b>\$ 6,100,000</b>	<b>\$ 1,980,000</b>	<b>32%</b>

Licensing revenues of \$406,000 and \$189,000, respectively, are also included in our calculation of product revenues for the six months ended September 30, 2012 and 2011 and are reflected in the table above under the respective geographic region where such licensing revenues were earned.

Service revenues decreased \$6,000 when compared to the same period in the prior year due to a decrease in the number of tests provided by our services business.

### ***Gross Profit***

We reported gross profit related to our Microcyn® products of \$6,000,000 or 74% of product revenues, during the six months ended September 30, 2012, compared to a gross profit of \$4,642,000, or 76% of product revenues, for the same period in the prior year. Our lower percentage of gross profitability is primarily the result of product mix in the United States and the impact of the execution of the More Pharma transaction in Mexico. Our margins in Mexico were 74% of product revenues during the six months ended September 30, 2012, compared to 81% for the same period in the prior year.

### ***Research and Development Expense***

Research and development expense increased \$49,000, or 5%, to \$1,045,000 for the six months ended September 30, 2012, compared to \$996,000 for the same period in the prior year due to increased tests and studies conducted during the six months ended September 30, 2012.

We expect that our research and development expense will increase slightly over the next few quarters as we incur additional expenses related to laboratory tests, clinical trials and the development and approval of new products.

### ***Selling, General and Administrative Expense***

Selling, general and administrative expense decreased \$28,000, or 1%, to \$6,351,000 during the six months ended September 30, 2012 as compared to \$6,379,000 for the same period in the prior year. The decrease for the six months ended September 30, 2012 was primarily due to a \$394,000 decline in stock compensation charges, partially offset by \$410,000 of one-time severance costs incurred in Mexico and higher expenses related to new products, compensation, and investor-related costs in the United States.

We expect selling, general and administrative expenses to decline in the next period as we see the impact of lower sales-related expenses in Mexico.

### ***Interest Expense and Interest Income***

Interest expense increased \$176,000 during the six months ended September 30, 2012 as compared to the same period in the prior year. The increase relates to an additional \$48,000 of cash interest incurred and an additional \$128,000 of non-cash interest incurred during the six months ended September 30, 2012. The cash and non-cash interest is related to borrowings from Venture Lending & Leasing V, Inc. and Venture Lending & Leasing VI, Inc. Interest income for the six months ended September 30, 2012 showed no material change from the same period in the prior year.

### ***Other Expense, Net***

Other expense, net decreased \$148,000 to \$46,000 for the six months ended September 30, 2012, compared to other expense, net of \$194,000 for the same period in the prior year. The change in other expense, net for the six months ended September 30, 2012 was primarily related to unrealized foreign exchange gains and losses on intercompany transactions and tax accruals.

### ***Derivative Liabilities***

During the six months ended September 30, 2012, we recorded an increase in the fair value of our derivative liabilities of \$850,000 and as a result, we recorded this amount as a non-cash gain. For the six months ended September 30, 2011, we recorded a non-cash gain of \$218,000. The change in the fair value of our derivative liability for the six months ended September 30, 2012 was primarily the result of decreases in our stock price and the issuance of warrants in connection with our registered direct offering that closed on April 22, 2012.

### ***Net (Loss)***

Net loss for the six months ended September 30, 2012 was \$1,074,000, a decrease of \$1,940,000, as compared to a net loss of \$3,014,000 for the same period in the prior year.

### **Liquidity and Capital Resources**

We reported a net loss of \$1,074,000 for the six months ended September 30, 2012. At September 30, 2012, our accumulated deficit amounted to \$133,388,000. We had working capital of \$4,996,000 as of September 30, 2012. In the future, we may raise additional capital from external sources in order to continue the longer term efforts contemplated under our business plan. We expect to continue incurring losses for the foreseeable future and may need to raise additional capital to pursue our product development initiatives, to penetrate markets for the sale of our products and continue as a going concern. We cannot provide any assurances that we will be able to raise additional capital. Our management believes that we have access to capital resources through possible public or private equity offerings, debt financings, corporate collaborations or other means, if needed; however, we have not secured any commitment for new financing at this time, nor can we provide any assurance that new financing will be available on commercially acceptable terms, if needed.

### **Sources of Liquidity**

As of September 30, 2012, we had cash and cash equivalents of \$8,310,000. Since our inception, substantially all of our operations have been financed through sales of equity securities. Other sources of financing that we have used to date include our revenues, as well as various loans.

Since October 1, 2010, substantially all of our operations have been financed through the following transactions:

- proceeds of \$149,000 received from the exercise of common stock purchase warrants and options;
- proceeds of \$3,000,000 received from the issuance of a debt instrument in the year ended March 31, 2011;
- proceeds of \$2,500,000 received from the issuance of a debt instrument in the year ended March 31, 2012;
- net proceeds of \$1,894,000 received from a registered direct offering of common stock on December 28, 2011; and
- net proceeds of \$2,832,000 received from a registered direct offering on April 22, 2012.

On April 22, 2012, we entered into agreements with institutional and accredited investors to issue up to: a) 2,360,001 shares of common stock b) 1,000 shares of Series A 0% Convertible Preferred Stock (the "Series A Preferred Stock"); and c) warrants to purchase up to 3,471,112 shares of common stock (the "Warrants"). We also offered up to 1,111,111 shares of common stock issuable upon conversion of the Series A Preferred Stock and 3,471,112 shares of common stock in the event the Warrants are exercised. The Warrants have an initial exercise price of \$1.18 per share, are not exercisable for six months from the date of issuance, and have an exercise term of 2.5 years from the date of issuance. We received approximately \$3,124,000 in gross proceeds from the sale of these securities. Net proceeds after deducting the placement agent commissions, legal expenses and other offering expenses, and assuming no exercise of the Warrants, was \$2,832,000. We retained Rodman & Renshaw, LLC as the exclusive placement agent for this offering, and paid them \$218,680 in placement agent commissions. On May 4, 2012, the investor converted 1,000 shares of the Series A Preferred Stock purchased in the transaction into 1,111,111 shares of common stock.

### **Cash Flows**

As of September 30, 2012, we had cash and cash equivalents of \$8,310,000, compared to \$3,351,000 at March 31, 2012.

Net cash provided by operating activities during the six months ended September 30, 2012 was \$3,292,000 primarily due to the receipt of a \$5,100,000 upfront payment from More Pharma offset by our net loss of \$1,074,000 for the period. Additionally, we had non-cash transactions during the six months ended September 30, 2012, including \$941,000 of stock-based compensation expenses, an \$850,000 gain on the fair value adjustment of our derivative liabilities, and non-cash interest of \$303,000.

Net cash used in operating activities during the six months ended September 30, 2011 was \$1,468,000 primarily due to our net loss of \$3,014,000 for the period which was offset in part by non-cash transactions during the six months ended September 30, 2011, including \$1,327,000 of stock-based compensation expenses, and a \$218,000 gain on the fair value adjustment of our derivative liability.

Net cash used in investing activities was \$205,000 for the six months ended September 30, 2012, consisting of \$62,000 related to equipment purchases and \$152,000 related to long-term prepaid expenses associated with the More Pharma transaction.

Net cash used in investing activities was \$174,000 for the six months ended September 30, 2011, consisting of \$72,000 related to equipment purchases and \$102,000 related to an increase in long-term deposits.

Net cash provided by financing activities was \$1,874,000 for the six months ended September 30, 2012. During the period ended September 30, 2012, we received net proceeds from the April 2012 registered direct offering of common and preferred stock of \$2,832,000. The offering proceeds were offset by principal payments on the debt in the amount of \$974,000.

Net cash provided by financing activities was \$949,000 for the six months ended September 30, 2011, primarily due to the issuance of \$1,500,000 of debt which was offset by payments of \$575,000 of outstanding debt during the period. We also received \$24,000 in connection with the exercise of stock options.

### **Operating Capital and Capital Expenditure Requirements**

We incurred a net loss of \$1,074,000 for the six months ended September 30, 2012. At September 30, 2012, our accumulated deficit amounted to \$133,388,000, and at March 31, 2012, our accumulated deficit amounted to \$132,314,000. At September 30, 2012, our working capital amounted to \$4,996,000.

We may raise additional capital from external sources in order to continue the longer term efforts contemplated under our business plan. We expect to continue incurring losses for the foreseeable future and may need to raise additional capital to pursue our product development initiatives and to penetrate markets for the sale of our products.

We have undertaken initiatives to reduce costs in an effort to conserve capital. Future pivotal trials will require the selection of a partner and must also be completed in order for us to potentially commercialize Microcyn® as a drug product in the United States. Commencement of the pivotal clinical trials will be delayed until we find a strategic partner to fund these trials. Without a strategic partner or additional capital, our pivotal clinical trials will be delayed for a period of time that is currently indeterminate.

Our future funding requirements will depend on many factors, including:

- the scope, rate of progress and cost of our clinical trials and other research and development activities;
- future clinical trial results;
- the terms and timing of any collaborative, licensing and other arrangements that we may establish;
- the cost and timing of regulatory approvals;
- the cost and delays in product development as a result of any changes in regulatory oversight applicable to our products;
- the cost and timing of establishing sales, marketing and distribution capabilities;
- the effect of competing technological and market developments;
- the cost of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights; and
- the extent to which we acquire or invest in businesses, products and technologies.

### **Use of Estimates**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates. These estimates and assumptions include reserves and write-downs related to receivables and inventories, the recoverability of long-term assets, deferred taxes and related valuation allowances and valuation of equity instruments

## Off-Balance Sheet Transactions

We currently have no off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

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

As a smaller reporting company, we are electing scaled disclosure reporting obligations and therefore are not required to provide the information required by this Item.

### Item 4. Controls and Procedures

(a) *Evaluation of Disclosure Controls and Procedures.* We maintain “disclosure controls and procedures,” as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, or the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission 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 timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Our disclosure controls and procedures have been designed to meet reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective at the reasonable assurance level.

(b) *Changes in Internal Controls.* There were no changes in our internal control over financial reporting that occurred during the fiscal quarter ended September 30, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II — OTHER INFORMATION

### Item 1. Legal Proceedings

On July 25, 2011, we received notice of a lawsuit filed in Mexico by Cesar Mangotich Pacheco and Prodinno, S.A. de C.V. represented by Cesar Mangotich Pacheco. The lawsuit appears to allege conversion of assets, tortious interference and defamation, among other claims. We are currently evaluating the lawsuit, conferring with local counsel and translating the documents we have received. Our preliminary assessment is that the lawsuit is completely without merit and intend to vigorously defend our position. We have not accrued a loss reserve for this matter.

Our Company, on occasion, may be involved in legal matters arising in the ordinary course of our business including matters involving proprietary technology. While management believes that such matters are currently insignificant, matters arising in the ordinary course of business for which we are or could become involved in litigation may have a material adverse effect on our business, financial condition or results of operations.

### Item 1A. Risk Factors

There have been no material changes from risk factors previously disclosed in our annual report on Form 10-K for the fiscal year ended March 31, 2012, as filed with the SEC on June 21, 2012, except as follows, which was also disclosed in our quarterly report on Form 10-Q for the quarter ended June 30, 2012:

*If any of our third-party contractors fail to perform their responsibilities to comply with FDA rules and regulations, the manufacture, marketing and sales of our products could be delayed, which could decrease our revenues.*

Supplying the market with our Microcyn® Technology products requires us to manage relationships with an increasing number of collaborative partners, suppliers and third-party contractors. As a result, our success depends partially on the success of these third parties in performing their responsibilities to comply with FDA rules and regulations. Although we pre-qualify our contractors and we believe that they are fully capable of performing their contractual obligations, we cannot directly control the adequacy and timeliness of the resources and expertise that they apply to these activities. For example, we and our suppliers are required to comply with the FDA's quality system regulations, which cover the methods and documentation of the design, testing, production, control, quality assurance, labeling, packaging, storage and shipping of our products. The FDA enforces the quality system regulation through inspections.

On July 25, 2012, we were notified that one of our strategic partners received a warning letter from the FDA regarding their manufacturing and marketing of certain Microcyn® Technology-based products. While we are still assessing the letter, we currently believe we do not have an obligation to respond to the FDA, although we may choose to assist our partner in their response. It is possible such letter will have a material impact on our business. However, we cannot predict when or how our partner will respond to the FDA or if our partner will adequately address all of the FDA's concerns. If our partner does not meet all of the FDA's concerns, our partner may cease selling some or all of our products. It is also possible that the FDA may require our partner to take other actions regarding our products including a recall. If our partner ceases to sell our products on a temporary or permanent basis, our revenues will be adversely affected.

If any of our partners or contractors fail to perform their obligations in an adequate and timely manner, or fail to comply with the FDA's rules and regulations, including failure to comply with quality systems regulations or a corrective action submitted to the FDA after notification by the FDA of a deficiency is deemed insufficient, then the manufacture, marketing and sales of our products could be delayed. Our products could be detained or seized, the FDA could order a recall, or require our partner to replace or offer refunds for our products. The FDA could also require our partner, and depending on our agreement with our partner, us to notify health professionals and others that the products present unreasonable risks of substantial harm to the public health. If any of these events occur, the manufacture, marketing and sales of our products could be delayed which could decrease our revenues.

*If we fail to comply with the FDA's rules and regulations and are subject to a FDA recall as part of an FDA enforcement action, the associated costs could like have a material adverse effect on our business, financial position, results of operations and cash flows.*

Our Company, our products, the manufacturing facilities for our products, the distribution of our products, and our promotion and marketing materials are subject to strict and continual review and periodic inspection by the FDA and other regulatory agencies for compliance with pre-approval and post-approval regulatory requirements.

If we fail to comply with the FDA's rules and regulations, we could be subject to an enforcement action by the FDA. The FDA could undertake regulatory actions, including seeking a consent decree, recalling or seizing our products, ordering a total or partial shutdown of production, delaying future marketing clearances or approvals, and withdrawing or suspending certain of our current products from the market. A product recall, restriction, or withdrawal could result in substantial and unexpected expenditures, destruction of product inventory, and lost revenues due to the unavailability of one or more of our products for a period of time, which could reduce profitability and cash flow. In addition, a product recall or withdrawal could divert significant management attention and financial resources. If any of our products are subject to an FDA recall, we could incur significant costs and suffer economic losses. Production of our products could be suspended and we could be required to establish inventory reserves to cover estimated inventory losses for all work-in-process and finished goods related to products we or our third-party contractors manufacture. A recall of a material amount of our products could have a significant, unfavorable impact on our future gross margins.

*If our products fail to comply with FDA and other governmental regulations, or our products are deemed defective, we may be required to recall our products and we could suffer adverse public relations that could adversely impact our sales, operating results, and reputation which would adversely affect our business operations.*

We may be exposed to product recalls, including voluntary recalls or withdrawals, and adverse public relations if our products are alleged to cause injury or illness, or if we are alleged to have mislabeled or misbranded our products or otherwise violated governmental regulations. Governmental authorities can also require product recalls or impose restrictions for product design, manufacturing, labeling, clearance, or other issues. For the same reasons, we may also voluntarily elect to recall, restrict the use of a product or withdraw products that we consider below our standards, whether for quality, packaging, appearance or otherwise, in order to protect our brand reputation.

Product recalls, product liability claims (even if unmerited or unsuccessful), or any other events that cause consumers to no longer associate our brand with high quality and safe products may also result in adverse publicity, hurt the value of our brand, harm our reputation among our customers and other healthcare professionals who use or recommend the products, lead to a decline in consumer confidence in and demand for our products, and lead to increased scrutiny by federal and state regulatory agencies of our operations, any of which could have a material adverse effect on our brand, business, performance, prospects, value, results of operations and financial condition.

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

During the three months ended September 30, 2012, we issued 26,096 shares of common stock to Advocos, LLC as compensation for services provided, and we also issued 150,000 shares of common stock to NetGain Financial, Inc. as compensation for services provided.

With respect to the issuance of securities described above, we relied on the Section 4(2) exemption from securities registration under the federal securities laws for transactions not involving any public offering. No advertising or general solicitation was employed in offering the securities. The securities were issued to an accredited investor. The securities were offered for investment purposes only and not for the purpose of resale or distribution, and the transfer thereof was appropriately restricted by us.

**Item 3. Default Upon Senior Securities**

We did not default upon any senior securities during the quarter ended September 30, 2012.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information***Property Lease Agreements*

On October 10, 2012, we entered into Amendment No. 7 to our property lease agreement, extending the lease on our Petaluma, California facility to September 30, 2017. Pursuant to the amendment, in exchange for certain improvements on the building, we agreed to increase the lease payment from \$10,380 to \$11,072 per month.

We have also entered into a property lease agreement for two properties in Sacramento, California:

- 3045 65th Street, Suite 13, Sacramento, CA 95820
- 3021 65th Street, Sacramento, CA 95820

On August 30, 2012, we entered into an amendment to our lease dated October 31, 2011 for the property located at 3045 65th Street, Suite 13, Sacramento, California 95820, to amend the lease to include a 3,000 square foot industrial unit located at 3021 65th Street, Sacramento, California, and to extend the lease on both properties to October 31, 2013. The total rent for both properties is \$2,610 per month.

*Agreement to Extend the Expiration Date of Warrants in Exchange for the Removal of Certain Settlement Features in Those Warrants*

On October 29, 2012, we entered into a side letter agreement with Sabby Healthcare Volatility Master Fund, Ltd. and Sabby Volatility Warrant Master Fund, Ltd. (collectively, "Sabby") to amend the terms of the warrants issued to Sabby in conjunction with our April 22, 2012 registered direct offering. Pursuant to the amendment, Sabby agreed to waive certain net-cash settlement features contained in the warrants in exchange for our agreement to a two-year extension of the expiration date of the warrants. Accordingly, the expiration date of the warrants issued to Sabby in connection with the April 22, 2012 registered direct offering was extended from October 25, 2014 to October 25, 2016. No other terms, rights or provisions of the purchase agreement or warrants were modified by the terms of the side letter agreement.

*Restructuring of Debt for Shares of Our Common Stock*

On May 1, 2010, we entered into a loan and security agreement and a supplement to the loan and security agreement with Venture Lending & Leasing V, Inc., to borrow up to an aggregate of \$3,000,000. In connection with those agreements, we issued two warrants to Venture Lending & Leasing V, LLC, a Delaware limited liability company ("LLC5"), which, in the aggregate, have a total put option cash value of \$750,000 (the "VLL5 Warrants").

On June 29, 2011, we entered into a loan and security agreement and a supplement to the loan and security agreement with Venture Lending & Leasing VI, Inc., to borrow up to an aggregate of up to \$2,500,000. In connection with those agreements, we issued three warrants to Venture Lending & Leasing VI, LLC, a Delaware limited liability company ("LLC6"), which, in the aggregate, have a total put option cash value of \$1,250,000 (the "VLL6 Warrants").

On October 30, 2012, we entered into a stock purchase agreement with LLC5 and LLC6 for the issuance to LLC5 and LLC6 of shares of our common stock having an aggregate fair market value equal to \$3,500,000, in exchange for LLC5's agreement to surrender the VLL5 Warrants and LLC6's agreement to surrender the VLL6 Warrants. The number of shares issued pursuant to the stock purchase agreement was calculated based upon a price of \$0.810 per share, the consolidated closing bid price as reported by The NASDAQ Capital Market for October 26, 2012, the previous trading day's consolidated closing bid price. Accordingly, on November 1, 2012, we issued an aggregate of 4,320,985 restricted shares of our common stock to LLC5 and LLC6, pursuant to the terms of the stock purchase agreement.

**Item 6. Exhibits**

<b>Exhibit No.</b>	<b>Description</b>
3.1	Restated Certificate of Incorporation of Oculus Innovative Sciences, Inc. (included as Exhibit 3.1 of the Company's Annual Report on Form 10-K filed June 20, 2007, and incorporated herein by reference).
3.2	Certificate of Amendment of Restated Certificate of Incorporation of Oculus Innovative Sciences, Inc. (included as Exhibit A in the Company's Definitive Proxy Statement on Schedule 14A filed July 21, 2008, and incorporated herein by reference).
3.3	Amended and Restated Bylaws, as Amended of Oculus Innovative Sciences, Inc., effective November 3, 2010 (included as Exhibit 3.3 to the Company's Quarterly Report on Form 10-Q filed November 4, 2010, and incorporated herein by reference).
4.1	Specimen Common Stock Certificate (included as Exhibit 4.1 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
4.2	Warrant to Purchase Series A Preferred Stock of Oculus Innovative Sciences, Inc. by and between the Company and Venture Lending & Leasing III, Inc., dated April 21, 2004 (included as Exhibit 4.2 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
4.3	Warrant to Purchase Series B Preferred Stock of Oculus Innovative Sciences, Inc. by and between the Company and Venture Lending & Leasing IV, Inc., dated June 14, 2006 (included as Exhibit 4.3 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
4.4	Form of Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. (included as Exhibit 4.4 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
4.5	Form of Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. (included as Exhibit 4.5 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
4.6	Form of Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. (included as Exhibit 4.11 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
4.7	Form of Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. (included as Exhibit 4.12 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
4.8	Form of Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. (included as Exhibit 10.3 to the Company's Current Report on Form 8-K filed August 13, 2007, and incorporated herein by reference).
4.9	Form of Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. (included as Exhibit 4.1 to the Company's Current Report on Form 8-K filed March 28, 2008, and incorporated herein by reference).
4.10	Form of Common Stock Purchase Warrant for April 2009 offering (included as Exhibit 4.15 to the Company's Registration Statement on Form S-1 (File No. 333-158539) declared effective on July 24, 2009, and incorporated herein by reference).
4.11	Warrant issued to Dayl Crow, dated March 4, 2009 (included as Exhibit 4.16 to the Company's Annual Report on Form 10-K filed June 11, 2009, and incorporated herein by reference).
4.12	Form of Common Stock Purchase Warrant for July 2009 offering (included as Exhibit 4.15 to the Company's Registration Statement on Form S-1 (File No. 333-158539), as amended, declared effective on July 24, 2009, and incorporated herein by reference).
4.13	Warrant to Purchase Shares of Common Stock of Oculus Innovative Sciences, Inc. issued to Venture Lending & Leasing V, LLC (included as Exhibit 10.3 to the Company's Current Report on Form 8-K filed May 6, 2010, and incorporated herein by reference).
4.14	Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. issued to Venture Lending & Leasing VI, LLC (included as Exhibit 10.3 to the Company's Current Report on Form 8-K filed July 6, 2011 and incorporated herein by reference).
4.15	Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. issued to Venture Lending & Leasing VI, LLC (included as Exhibit 4.15 to the Company's Quarterly Report on Form 10-Q filed November 3, 2011, and incorporated herein by reference).
4.16	Warrant to Purchase Common Stock of Oculus Innovative Sciences, Inc. issued to Venture Lending & Leasing VI, LLC (included as Exhibit 4.16 to the Company's Quarterly Report on Form 10-Q, filed February 10, 2012, and incorporated herein by reference).
4.17	Form of Common Stock Purchase Warrant for April 2012 offering (included as Exhibit 4.1 to the Company's Current Report on Form 8-K, filed April 25, 2012, and incorporated herein by reference).
4.18	Certificate of Designation of Preferences, Rights and Limitations of Series A 0% Convertible Preferred Stock, filed with the Delaware Secretary of State on April 24, 2012 (included as Exhibit 4.2 to the Company's Current Report on Form 8-K, filed April 25, 2012, and incorporated herein by reference).

- 10.1 Form of Indemnification Agreement between Oculus Innovative Sciences, Inc. and its officers and directors (included as Exhibit 10.1 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.2 Amended and Restated Oculus Innovative Sciences, Inc. 2006 Stock Incentive Plan and related form stock option plan agreements (included as Exhibit 10.2 to the Company's Current Report on Form 8-K filed May 2, 2007, and incorporated herein by reference).
- 10.3 Amended and Restated Investors Rights Agreement, effective as of September 14, 2006 (included as Exhibit 4.6 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.4 Form of Promissory Note (Growth Capital Loans) issued to Venture Lending & Leasing IV, Inc. (included as Exhibit 4.9 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.5 Office Lease Agreement, dated October 26, 1999, between Oculus Innovative Sciences, Inc. and RNM Lakeville, L.P. (included as Exhibit 10.7 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.6 Amendment No. 1 to Office Lease Agreement, dated September 15, 2000, between Oculus Innovative Sciences, Inc. and RNM Lakeville L.P. (included as Exhibit 10.8 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.7 Amendment No. 2 to Office Lease Agreement, dated July 29, 2005, between Oculus Innovative Sciences, Inc. and RNM Lakeville L.P. (included as Exhibit 10.9 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.8 Amendment No. 3 to Office Lease Agreement, dated August 23, 2006, between Oculus Innovative Sciences, Inc. and RNM Lakeville L.P. (included as Exhibit 10.23 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.9 Amendment No. 4 to Office Lease Agreement, dated September 13, 2007, by and between Oculus Innovative Sciences, Inc. and RNM Lakeville L.P. (included as Exhibit 10.43 to the Company's Annual Report on Form 10-K filed June 13, 2008, and incorporated herein by reference).
- 10.10 Office Lease Agreement, dated May 18, 2006, between Oculus Technologies of Mexico, S.A. de C.V. and Antonio Sergio Arturo Fernandez Valenzuela (translated from Spanish) (included as Exhibit 10.10 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.11 Office Lease Agreement, dated July 2003, between Oculus Innovative Sciences, B.V. and Artikona Holding B.V. (translated from Dutch) (included as Exhibit 10.11 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.12 Amendment to Office Lease Agreement, effective February 15, 2008, by and between Oculus Innovative Sciences Netherlands B.V. and Artikona Holding B.V. (translated from Dutch) (included as Exhibit 10.44 to the Company's Annual Report on Form 10-K filed June 13, 2008, and incorporated herein by reference).
- 10.13 Form of Director Agreement (included as Exhibit 10.20 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.14 Framework Agreement, dated June 16, 2005, by and among Javier Orozco Gutierrez, Quimica Pasteur, S de R.L., Jorge Paulino Hermosillo Martin, Oculus Innovative Sciences, Inc. and Oculus Technologies de Mexico, S.A. de C.V. (included as Exhibit 10.25 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.15 Mercantile Consignment Agreement, dated June 16, 2005, between Oculus Technologies de Mexico, S.A. de C.V., Quimica Pasteur, S de R.L. and Francisco Javier Orozco Gutierrez (included as Exhibit 10.26 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.16 Partnership Interest Purchase Option Agreement, dated June 16, 2005, by and between Oculus Innovative Sciences, Inc. and Javier Orozco Gutierrez (included as Exhibit 10.27 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.17 Termination of Oculus Innovative Sciences, Inc. and Oculus Technologies de Mexico, S.A. de C.V.'s Agreements with Quimica Pasteur, S de R.L. by Jorge Paulino Hermosillo Martin (translated from Spanish) (included as Exhibit 10.28 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.18 Termination of Oculus Innovative Sciences, Inc. and Oculus Technologies de Mexico, S.A. de C.V.'s Agreements with Quimica Pasteur, S de R.L. by Francisco Javier Orozco Gutierrez (translated from Spanish) (included as Exhibit 10.29 to the Company's Registration Statement on Form S-1 (File No. 333-135584), as amended, declared effective on January 24, 2007, and incorporated herein by reference).
- 10.19 Form of Securities Purchase Agreement, dated March 27, 2008, by and between Oculus Innovative Sciences, Inc. and each investor signatory thereto (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed March 28, 2008, and incorporated herein by reference).



- 10.20 Purchase Agreement by and between Oculus Innovative Sciences, Inc. and Robert Burlingame, dated January 26, 2009 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed January 29, 2009, and incorporated herein by reference).
- 10.21 Purchase Agreement by and between Oculus Innovative Sciences, Inc. and Non-Affiliated Investors, dated January 26, 2009 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K filed January 29, 2009, and incorporated herein by reference).
- 10.22 Revenue Sharing Distribution Agreement by and between Oculus Innovative Sciences, Inc. and VetCure, Inc., dated January 26, 2009 (included as Exhibit 10.3 to the Company's Current Report on Form 8-K filed January 29, 2009, and incorporated herein by reference).
- 10.23 Purchase Agreement by and between Oculus Innovative Sciences, Inc. and accredited investors, dated February 6, 2009 (refiled as Exhibit 10.32 to the Company's Quarterly Report on Form 10-Q filed November 4, 2010, and incorporated herein by reference).
- 10.24 Purchase Agreement by and between Oculus Innovative Sciences, Inc., Robert Burlingame and Seamus Burlingame, dated February 24, 2009 (included as Exhibit 10.4 to the Company's Current Report on Form 8-K filed February 27, 2009, and incorporated herein by reference).
- 10.25 Amendment No. 1 to Revenue Sharing Distribution Agreement by and between Oculus Innovative Sciences, Inc. and VetCure, Inc., dated February 24, 2009 (included as Exhibit 10.5 to the Company's Current Report on Form 8-K filed February 27, 2009, and incorporated herein by reference).
- 10.26 Consultant Agreement by and between Oculus Innovative Sciences, Inc. and Robert C. Burlingame, dated April 1, 2009 (included as Exhibit 10.52 to the Company's Annual Report on Form 10-K filed June 11, 2009, and incorporated herein by reference).
- 10.27 Microcyn U.S. Commercial Launch Agreement by and between Oculus Innovative Sciences, Inc. and Advocos, dated April 24, 2009 (included as Exhibit 10.53 to the Company's Annual Report on Form 10-K filed June 11, 2009, and incorporated herein by reference).
- 10.28 Amendment No. 5 to Office Lease Agreement by and between Oculus Innovative Sciences, Inc. and RNM Lakeville, LLC, dated May 18, 2009 (included as Exhibit 10.54 to the Company's Annual Report on Form 10-K filed June 11, 2009, and incorporated herein by reference).
- 10.29 Engagement Agreement by and between Oculus Innovative Sciences, Inc. and Dawson James Securities, Inc., dated April 10, 2009 (included as Exhibit 10.55 to the Company's Registration Statement on Form S-1 (File No. 333-158539), as amended, declared effective on July 24, 2009, and incorporated herein by reference).
- 10.30 Amendment and Clarification of Engagement Letter by and between Oculus Innovative Sciences, Inc. and Dawson James Securities, Inc., dated July 2, 2009 (included as Exhibit 10.56 to the Company's Registration Statement on Form S-1 (File No. 333-158539), as amended, declared effective on July 24, 2009, and incorporated herein by reference).
- 10.31 Second Amendment and Clarification of Engagement Letter by and between Oculus Innovative Sciences, Inc. and Dawson James Securities, Inc., dated July 10, 2009 (included as Exhibit 10.57 to the Company's Registration Statement on Form S-1 (File No. 333-158539), as amended, declared effective on July 24, 2009, and incorporated herein by reference).
- 10.32 Warrant Purchase Agreement by and between Oculus Innovative Sciences, Inc. and Dawson James Securities, Inc., dated July 13, 2009 (included as Exhibit 10.58 to the Company's Registration Statement on Form S-1 (File No. 333-158539), as amended, declared effective on July 24, 2009, and incorporated herein by reference).
- 10.33 Loan and Security Agreement between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing V, Inc., dated May 1, 2010 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed May 6, 2010, and incorporated herein by reference).
- 10.34 Supplement to the Loan and Security Agreement between Oculus Innovative Sciences, Inc., and Venture Lending & Leasing V, Inc., dated May 1, 2010 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K filed May 6, 2010, and incorporated herein by reference).
- 10.35† Amendment No. 2 to Revenue Sharing, Partnership and Distribution Agreement between Oculus Innovative Sciences, Inc. and Vetericyn, Inc., dated July 24, 2009 (refiled as Exhibit 10.44 to the Company's Quarterly Report on Form 10-Q/A for the quarter ended September 30, 2010 filed April 29, 2011, and incorporated herein by reference).
- 10.36† Amendment No. 3 to Revenue Sharing, Partnership and Distribution Agreement between Oculus Innovative Sciences, Inc. and Vetericyn, Inc., dated June 1, 2010 (refiled as Exhibit 10.44 to the Company's Quarterly Report on Form 10-Q/A for the quarter ended June 30, 2010 filed April 29, 2011, and incorporated herein by reference).
- 10.37† Amendment No. 1 to Exhibit A to the Revenue Sharing Distribution Agreement and to the Revenue Sharing, Partnership and Distribution Agreement as Revised and Amended, June 1, 2010, dated September 1, 2010 (included as Exhibit 10.46 to the Company's Quarterly Report on Form 10-Q filed November 4, 2010, and incorporated herein by reference).
- 10.38 Continuous Offering Program Agreement between Oculus Innovative Sciences, Inc. and Rodman & Renshaw, LLC, dated September 3, 2010 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed September 17, 2010, and incorporated herein by reference).

- 10.39† Distribution Agreement between Oculus Innovative Sciences, Inc. and Tianjin Ascent Import and Export Company, Ltd., dated January 28, 2011 (included as Exhibit 10.47 to the Company's Quarterly Report on Form 10-Q filed February 4, 2011, and incorporated herein by reference).
- 10.40† Exclusive Sales and Distribution Agreement between Oculus Innovative Sciences, Inc. and Quinnova Pharmaceuticals, Inc., dated February 14, 2011 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed February 18, 2011, and incorporated herein by reference).
- 10.41† Exclusive Co-Promotion Agreement between Oculus Innovative Sciences, Inc. and Quinnova Pharmaceuticals, Inc., dated February 14, 2011 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K filed February 18, 2011, and incorporated herein by reference).
- 10.42 Product Option Agreement between Oculus Innovative Sciences, Inc. and AmDerma Pharmaceuticals, LLC, dated February 14, 2011 (included as Exhibit 10.3 to the Company's Current Report on Form 8-K filed February 18, 2011, and incorporated herein by reference).
- 10.43 Amendment No. 6 to Office Lease Agreement by and between Oculus Innovative Sciences, Inc. and RNM Lakeville, L.P., dated April 26, 2011 (included as Exhibit 10.52 to the Company's Annual Report on Form 10-K filed June 3, 2011, and incorporated herein by reference).
- 10.44 Loan and Security Agreement between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing VI, Inc., dated June 29, 2011 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K filed July 6, 2011, and incorporated herein by reference).
- 10.45 Supplement to the Loan and Security Agreement between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing VI, Inc., dated June 29, 2011 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K filed July 6, 2011, and incorporated herein by reference).
- 10.46 Amendment No. 1 to the Loan and Security Agreement and Supplement to the Loan and Security Agreement between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing V, Inc., dated June 29, 2011 (included as Exhibit 10.4 to the Company's Current Report on Form 8-K filed July 6, 2011, and incorporated herein by reference).
- 10.47 Intellectual Property Security Agreement between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing VI, Inc., dated June 29, 2011 (included as Exhibit 10.5 to the Company's Current Report on Form 8-K filed July 6, 2011, and incorporated herein by reference).
- 10.48 Intellectual Property Security Agreement between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing V, Inc., dated June 29, 2011 (included as Exhibit 10.6 to the Company's Current Report on Form 8-K filed July 6, 2011, and incorporated herein by reference).
- 10.49† Distribution Agreement between Oculus Innovative Sciences, Inc. and Shanghai Sunvic Technology Co. Ltd., dated June 26, 2011 (included as Exhibit 10.58 to the Company's Quarterly Report on Form 10-Q filed August 4, 2011 and incorporated herein by reference).
- 10.50 Oculus Innovative Sciences, Inc. 2011 Stock Incentive Plan (included as Exhibit A in the Company's Definitive Proxy Statement on Schedule 14A filed July 29, 2011, and incorporated herein by reference).
- 10.51 Securities Purchase Agreement by and between Oculus Innovative Sciences, Inc. and the Purchasers, dated April 22, 2012 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed April 25, 2012, and incorporated herein by reference).
- 10.52† Patent License Agreement-Exclusive between Oculus Innovative Sciences, Inc. and agencies of the United States Public Health Service within the Department of Health and Human Services, dated August 22, 2011 (included as Exhibit 10.60 to the Company's Quarterly Report on Form 10-Q filed November 3, 2011, and incorporated herein by reference).
- 10.53† Collaboration Agreement between Oculus Innovative Sciences, Inc. and AmDerma Pharmaceuticals, LLC, dated June 21, 2012 (included as Exhibit 10.53 to the Company's Annual Report on Form 10-K filed June 21, 2012 and incorporated herein by reference).
- 10.54† License, Exclusive Distribution and Supply Agreement by and between Oculus Innovative Sciences, Inc. and Oculus Technologies of Mexico, S.A. de C.V., and, More Pharma Corporation, S. de R.L. de C.V., dated August 9, 2012 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed August 15, 2012, and incorporated herein by reference).
- 10.55† Exclusive Distribution and Supply Agreement by and between Oculus Innovative Sciences, Inc. and Oculus Technologies of Mexico, S.A. de C.V., and, More Pharma Corporation, S. de R.L. de C.V., dated August 9, 2012 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K, filed August 15, 2012, and incorporated herein by reference).
- 10.56\* Lease by and between Oculus Innovative Sciences, Inc. and KCKMC Properties, LLP for the property located at 3045 65th Street, Suite 13, Sacramento, CA 95820, dated October 31, 2011
- 10.57\* Amendment to Lease dated August 30, 2012 by and between Oculus Innovative Sciences, Inc. and KCKMC Properties, LLC for the property located at 3045 65th Street, Suite 13, Sacramento, CA 95820, dated September 6, 2012
- 10.58\* Amendment No. 7 to Office Lease Agreement by and between Oculus Innovative Sciences, Inc. and 1125-1137 North McDowell, LLC, dated October 10, 2012
- 10.59 Stock Purchase Agreement by and between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing V, LLC and Venture Lending & Leasing VI, LLC, dated October 30, 2012 (included as Exhibit 10.1 to the Company's Current Report on Form 8-K, filed November 1, 2012, and incorporated herein by reference).

10.60	Letter Agreement by and between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing V, Inc., dated October 30, 2012 (included as Exhibit 10.2 to the Company's Current Report on Form 8-K, filed November 1, 2012, and incorporated herein by reference).
10.61	Letter Agreement by and between Oculus Innovative Sciences, Inc. and Venture Lending & Leasing VI, Inc., dated October 30, 2012 (included as Exhibit 10.3 to the Company's Current Report on Form 8-K, filed November 1, 2012, and incorporated herein by reference).
10.62	Side Letter Agreement to the Stock Purchase Agreement dated April 22, 2012 by and between Oculus Innovative Sciences, Inc., on one hand, and Sabby Healthcare Volatility Master Fund, Ltd. and Sabby Volatility Warrant Master Fund, Ltd. on the other hand, dated October 29, 2012 (included as Exhibit 10.4 to the Company's Current Report on Form 8-K, filed November 1, 2012, and incorporated herein by reference).
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Officers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase.
101.LAB*	XBRL Taxonomy Extension Label Linkbase.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase.

\* Filed herewith.

† Confidential treatment has been granted with respect to certain portions of this agreement.

#### 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.

#### OCULUS INNOVATIVE SCIENCES, INC.

Date: November 8, 2012

By: /s/ Hojabr Alimi  
 Hojabr Alimi  
 Chairman of the Board of Directors and Chief Executive  
 Officer  
 (Principal Executive Officer)

Date: November 8, 2012

By: /s/ Robert Miller  
 Robert Miller  
 Chief Financial Officer  
 (Principal Financial Officer and Principal Accounting  
 Officer)



AIR COMMERCIAL REAL ESTATE ASSOCIATION
STANDARD INDUSTRIAL/COMMERCIAL
MULTI-TENANT LEASE - GROSS

1. Basic Provisions ("Basic Provisions").

1.1 Parties: This Lease ("Lease"), dated for reference purposes only October 31, 2011, is made by and between SCMRC Properties, LLP

and Oculus Inc., A Delaware Corporation ("Lessor")

and ("Lessee"), (collectively the "Parties", or individually a "Party").

1.2(a) Premises: That certain portion of the Project (as defined below), including all improvements therein or to be provided by Lessor under the terms of this Lease, commonly known by the street address of 3045 65th Street, Suite 13, located in the City of Sacramento, County of Sacramento, State of California, with zip code 95820, as outlined on Exhibit attached hereto ("Premises") and generally described as (describe briefly the nature of the Premises): An approximate 1,600 square foot unit located in a +/-95,000 square foot multi-tenant building

In addition to Lessor's rights to use and occupy the Premises as hereinafter specified, Lessee shall have non-exclusive rights to any utility raceways of the building containing the Premises ("Building") and to the Common Areas (as defined in Paragraph 2.7 below), but shall not have any rights to the roof, or exterior walls of the Building or to any other buildings in the Project. The Premises, the Building, the Common Areas, the land upon which they are located, along with all other buildings and improvements thereon, are herein collectively referred to as the "Project." (See also Paragraph 2)

1.2(b) Parking Pro-rata unreserved vehicle parking spaces. (See also Paragraph 2.6)

1.3 Term: 1 years and 1 months ("Original Term") commencing December 1, 2011

("Commencement Date") and ending December 31, 2012 ("Expiration Date"). (See also Paragraph 3)

1.4 Early Possession: If the Premises are available Lessee may have non-exclusive possession of the Premises commencing Upon mutual lease execution ("Early Possession Date"). (See also Paragraphs 3.2 and 3.3)

1.5 Base Rent: \$ 810.00 per month ("Base Rent"), payable on the 1st day of each month commencing December 1, 2011. (See also Paragraph 4)

If this box is checked, there are provisions in this Lease for the Base Rent to be adjusted. See Paragraph

1.6 Lessor's Share of Common Area Operating Expenses: N/A percent ( 0 %) ("Lessee's Share").

In the event that the size of the Premises and/or the Project are modified during the term of this Lease, Lessor shall recalculate Lessee's Share to reflect such modification.

1.7 Base Rent and Other Monies Paid Upon Execution: (a) Base Rent: \$ 810.00 for the period January 1, 2012 - January 31, 2012

(b) Common Area Operating Expenses: \$ N/A for the period

(c) Security Deposit: \$ 810.00 ("Security Deposit"). (See also Paragraph 5)

(d) Other: \$ N/A for N/A

(e) Total Due Upon Execution of this Lease: \$ 1,620.00

1.8 Agreed Use: General Office and warehouse use for a dried food storage allowed under current C-2 zoning

(See also Paragraph 6)

1.9 Insuring Party: Lessor is the "Insuring Party". (See also Paragraph 8)

1.10 Real Estate Brokers: (See also Paragraph 15)

(a) Representation: The following real estate brokers (the "Brokers") and brokerage relationships exist in this transaction (check applicable boxes):

represents Lessor exclusively ("Lessor's Broker");

represents Lessee exclusively ("Lessee's Broker"); or

represents both Lessor and Lessee ("Dual Agency").

(b) Payment to Brokers: Upon execution and delivery of this Lease by both Parties, Lessor shall pay to the Brokers

the brokerage fee agreed to in a separate written agreement (or if there is no such agreement, the sum of or % of the total Base Rent for the brokerage services rendered by the Brokers).

1.11 Guarantor: The obligations of the Lessee under this Lease are to be guaranteed by

("Guarantor"). (See also Paragraph 37)

1.12 Attachments: Attached hereto are the following, all of which constitute a part of this Lease:

an Addendum consisting of Paragraphs 50 through 59;

a site plan depicting the Premises;

INITIALS

INITIALS

- £ a site plan depicting the Project;
  - £ a current set of the Rules and Regulations for the Project;
  - £ a current set of the Rules and Regulations adopted by the owners' association;
  - £ a Work Letter;
  - £ other (specify):
- 
- 
- 

## 2. Premises.

2.1 **Letting.** Lessor hereby leases to Lessee, and Lessee hereby leases from Lessor, the Premises, for the term, at the rental, and upon all of the terms, covenants and conditions set forth in this Lease. While the approximate square footage of the Premises may have been used in the marketing of the Premises for purposes of comparison, the Base Rent stated herein is NOT tied to square footage and is not subject to adjustment should the actual size be determined to be different. **NOTE: Lessee is advised to verify the actual size prior to executing this Lease.**

2.2 **Condition.** Lessor shall deliver that portion of the Premises contained within the Building (“Unit”) to Lessee broom clean and free of debris on the Commencement Date or the Early Possession Date, whichever first occurs (“Start Date”), and, so long as the required service contracts described in Paragraph 7.1(b) below are obtained by Lessee and in effect within thirty days following the Start Date, warrants that the existing electrical, plumbing, fire sprinkler, lighting, heating, ventilating and air conditioning systems (“HVAC”), loading doors, sump pumps, if any, and all other such elements in the Unit, other than those constructed by Lessee, shall be in good operating condition on said date, that the structural elements of the roof, bearing walls and foundation of the Unit shall be free of material defects, and that the Unit does not contain hazardous levels of any mold or fungi defined as toxic under applicable state or federal law. If a non-compliance with such warranty exists as of the Start Date, or if one of such systems or elements should malfunction or fail within the appropriate warranty period, Lessor shall, as Lessor's sole obligation with respect to such matter, except as otherwise provided in this Lease, promptly after receipt of written notice from Lessee setting forth with specificity the nature and extent of such non-compliance, malfunction or failure, rectify same at Lessor's expense. The warranty periods shall be as follows: (i) 6 months as to the HVAC systems, and (ii) 30 days as to the remaining systems and other elements of the Unit. If Lessee does not give Lessor the required notice within the appropriate warranty period, correction of any such non-compliance, malfunction or failure shall be the obligation of Lessee at Lessee's sole cost and expense (except for the repairs to the fire sprinkler systems, roof, foundations, and/or bearing walls - see Paragraph 7).

2.3 **Compliance.** Lessor warrants that to the best of its knowledge the improvements on the Premises and the Common Areas comply with the building codes that were in effect at the time that each such improvement, or portion thereof, was constructed, and also with all applicable laws, covenants or restrictions of record, regulations, and ordinances in effect on the Start Date (“Applicable Requirements”). Said warranty does not apply to the use to which Lessee will put the Premises, modifications which may be required by the Americans with Disabilities Act or any similar laws as a result of Lessee's use (see Paragraph 49). or to any Alterations or Utility Installations (as defined in Paragraph 7.3(a)) made or to be made by Lessee **NOTE: Lessee is responsible for determining whether or not the Applicable Requirements, and especially the zoning are appropriate for Lessee's intended use, and acknowledges that past uses of the Premises may no longer be allowed.** If the Premises do not comply with said warranty, Lessor shall, except as otherwise provided, promptly after receipt of written notice from Lessee setting forth with specificity the nature and extent of such non-compliance, rectify the same at Lessor's expense. If Lessee does not give Lessor written notice of a non-compliance with this warranty within 6 months following the Start Date, correction of that noncompliance shall be the obligation of Lessee at Lessee's sole cost and expense. If the Applicable Requirements are hereafter changed so as to require during the term of this Lease. the construction of an addition to or an alteration of the Unit, Premises and/or Building, the remediation of any Hazardous Substance, or the reinforcement or other physical modification of the Unit, Premises and/or Building (“Capital Expenditure”), Lessor and Lessee shall allocate the cost of such work as follows:

(a) Subject to Paragraph 2.3(c) below, if such Capital Expenditures are required as a result of the specific and unique use of the Premises by Lessee as compared with uses by tenants in general, Lessee shall be fully responsible for the cost thereof, provided, however, that if such Capital Expenditure is required during the last 2 years of this Lease and the cost thereof exceeds 6 months' Base Rent, Lessee may instead terminate this Lease unless Lessor notifies Lessee, in writing, within 10 days after receipt of Lessee's termination notice that Lessor has elected to pay the difference between the actual cost thereof and the amount equal to 6 months' Base Rent. If Lessee elects termination, Lessee shall immediately cease the use of the Premises which requires such Capital Expenditure and deliver to Lessor written notice specifying a termination date at least 90 days thereafter. Such termination date shall, however, in no event be earlier than the last day that Lessee could legally utilize the Premises without commencing such Capital Expenditure.

(b) If such Capital Expenditure is not the result of the specific and unique use of the Premises by Lessee (such as, governmentally mandated seismic modifications), then Lessor shall pay for such Capital Expenditure and Lessee shall only be obligated to pay, each month during the remainder of the term of this Lease or any extension thereof, on the date that on which the Base Rent is due, an amount equal to 144th of the portion of such costs reasonably attributable to the Premises. Lessee shall pay Interest on the balance but may prepay its obligation at any time. If, however, such Capital Expenditure is required during the last 2 years of this Lease or if Lessor reasonably determines that it is not economically feasible to pay its share thereof, Lessor shall have the option to terminate this Lease upon 90 days prior written notice to Lessee unless Lessee notifies Lessor, in writing, within 10 days after receipt of Lessor's termination notice that Lessee will pay for such Capital Expenditure. If Lessor does not elect to terminate, and fails to tender its share of any such Capital Expenditure, Lessee may advance such funds and deduct same, with Interest, from Rent until Lessor's share of such costs have been fully paid. If Lessee is unable to finance Lessor's share, or if the balance of the Rent due and payable for the remainder of this Lease is not sufficient to fully reimburse Lessee on an offset basis, Lessee shall have the right to terminate this Lease upon 30 days written notice to Lessor.

(c) Notwithstanding the above, the provisions concerning Capital Expenditures are intended to apply only to non-voluntary, unexpected, and new Applicable Requirements. If the Capital Expenditures are instead triggered by Lessee as a result of an actual or

proposed change in use, change in intensity of use, or modification to the Premises then, and in that event, Lessee shall either: (i) immediately cease such changed use or intensity of use and/or take such other steps as may be necessary to eliminate the requirement for such Capital Expenditure, or (ii) complete such Capital Expenditure at its own expense. Lessee shall not have any right to terminate this Lease.

2.4 **Acknowledgements.** Lessee acknowledges that: (a) it has been given an opportunity to inspect and measure the Premises, (b) it has been advised by Lessor and/or Brokers to satisfy itself with respect to the size and condition of the Premises (including but not limited to the electrical, HVAC and fire sprinkler systems, security, environmental aspects, and compliance with Applicable Requirements and the Americans with Disabilities Act), and their suitability for Lessee's intended use, (c) Lessee has made such investigation as it deems necessary with reference to such matters and assumes all responsibility therefor as the same relate to its occupancy of the Premises, (d) it is not relying on any representation as to the size of the Premises made by Brokers or Lessor, (e) the square footage of the Premises was not material to Lessee's decision to lease the Premises and pay the Rent stated herein, and (f) neither Lessor, Lessor's agents, nor Brokers have made any oral or written representations or warranties with respect to said matters other than as set forth in this Lease. In addition, Lessor acknowledges that: (i) Brokers have made no representations, promises or warranties concerning Lessee's ability to honor the Lease or suitability to occupy the Premises, and (ii) it is Lessor's sole responsibility to investigate the financial capability and/or suitability of all proposed tenants.

2 . 5 **Lessee as Prior Owner/Occupant.** The warranties made by Lessor in Paragraph 2 shall be of no force or effect if immediately prior to the Start Date Lessee was the owner or occupant of the Premises. In such event, Lessee shall be responsible for any necessary corrective work.

2.6 **Vehicle Parking.** Lessee shall be entitled to use the number of Parking Spaces specified in Paragraph 1.2(b) on those portions of the Common Areas designated from time to time by Lessor for parking. Lessee shall not use more parking spaces than said number. Said parking spaces shall be used for parking by vehicles no larger than full-size passenger automobiles or pick-up trucks, herein called "**Permitted Size Vehicles.**" Lessor may regulate the loading and unloading of vehicles by adopting Rules and Regulations as provided in Paragraph 2.9. No vehicles other than Permitted Size Vehicles may be parked in the Common Area without the prior written permission of Lessor. In addition:

(a) Lessee shall not permit or allow any vehicles that belong to or are controlled by Lessee or Lessee's employees, suppliers, shippers, customers, contractors or invitees to be loaded, unloaded, or parked in areas other than those designated by Lessor for such activities.

(b) Lessee shall not service or store any vehicles in the Common Areas.

(c) If Lessee permits or allows any of the prohibited activities described in this Paragraph 2.6, then Lessor shall have the right, without notice, in addition to such other rights and remedies that it may have, to remove or tow away the vehicle involved and charge the cost to Lessee, which cost shall be immediately payable upon demand by Lessor.

2 . 7 **Common Areas - Definition.** The term "**Common Areas**" is defined as all areas and facilities outside the Premises and within the exterior boundary line of the Project and interior utility raceways and installations within the Unit that are provided and designated by the Lessor from time to time for the general non-exclusive use of Lessor, Lessee and other tenants of the Project and their respective employees, suppliers, shippers, customers, contractors and invitees, including parking areas, loading and unloading areas, trash areas, roadways, walkways, driveways and landscaped areas.

2.8 **Common Areas - Lessee's Rights.** Lessor grants to Lessee, for the benefit of Lessee and its employees, suppliers, shippers, contractors, customers and invitees, during the term of this Lease, the non-exclusive right to use, in common with others entitled to such use, the Common Areas as they exist from time to time, subject to any rights, powers, and privileges reserved by Lessor under the terms hereof or under the terms of any rules and regulations or restrictions governing the use of the Project. Under no circumstances shall the right herein granted to use the Common Areas be deemed to include the right to store any property, temporarily or permanently, in the Common Areas. Any such storage shall be permitted only by the prior written consent of Lessor or Lessor's designated agent, which consent may be revoked at any time. In the event that any unauthorized storage shall occur, then Lessor shall have the right, without notice, in addition to such other rights and remedies that it may have, to remove the property and charge the cost to Lessee, which cost shall be immediately payable upon demand by Lessor.

2 . 9 **Common Areas - Rules and Regulations.** Lessor or such other person(s) as Lessor may appoint shall have the exclusive control and management of the Common Areas and shall have the right, from time to time, to establish, modify, amend and enforce reasonable rules and regulations ("**Rules and Regulations**") for the management, safety, care, and cleanliness of the grounds, the parking and unloading of vehicles and the preservation of good order, as well as for the convenience of other occupants or tenants of the Building and the Project and their invitees. Lessee agrees to abide by and conform to all such Rules and Regulations, and shall use its best efforts to cause its employees, suppliers, shippers, customers, contractors and invitees to so abide and conform. Lessor shall not be responsible to Lessee for the non-compliance with said Rules and Regulations by other tenants of the Project.

2.10 **Common Areas - Changes.** Lessor shall have the right, in Lessor's sole discretion, from time to time:

(a) To make changes to the Common Areas, including, without limitation, changes in the location, size, shape and number of driveways, entrances, parking spaces, parking areas, loading and unloading areas, ingress, egress, direction of traffic, landscaped areas, walkways and utility raceways;

(b) To close temporarily any of the Common Areas for maintenance purposes so long as reasonable access to the Premises remains available;

(c) To designate other land outside the boundaries of the Project to be a part of the Common Areas;

(d) To add additional buildings and improvements to the Common Areas;

(e) To use the Common Areas while engaged in making additional improvements, repairs or alterations to the Project, or any portion thereof; and

(f) To do and perform such other acts and make such other changes in, to or with respect to the Common Areas and Project as Lessor may, in the exercise of sound business judgment, deem to be appropriate.

### 3. **Term.**

3.1 **Term.** The Commencement Date, Expiration Date and Original Term of this Lease are as specified in Paragraph 1.3.

3.2 **Early Possession.** Any provision herein granting Lessee Early Possession of the Premises is subject to and conditioned upon the Premises being available for such possession prior to the Commencement Date. Any grant of Early Possession only conveys a non-exclusive right to occupy the Premises. If Lessee totally or partially occupies the Premises prior to the Commencement Date, the obligation to pay Base Rent shall be abated for the period of such Early Possession. All other terms of this Lease (including but not limited to the obligations to pay Lessee's Share of Common Area Operating Expenses, Real Property Taxes and insurance premiums and to maintain the Premises) shall be in effect during such period. Any such Early Possession shall not affect the Expiration Date.

3.3 **Delay In Possession.** Lessor agrees to use its best commercially reasonable efforts to deliver possession of the Premises to Lessee by the Commencement Date. If, despite said efforts, Lessor is unable to deliver possession as agreed, Lessor shall not be subject to any liability therefor, nor shall such failure affect the validity of this Lease or change the Expiration Date. Lessee shall not, however, be obligated to pay Rent or perform its other obligations until Lessor delivers possession of the Premises and any period of rent abatement that Lessee would otherwise have enjoyed shall run from the date of the delivery of possession and continue for a period equal to what Lessee would otherwise have enjoyed, but minus any days of delay caused by the acts or omissions of Lessee. If possession is not delivered within 60 days after the Commencement Date, Lessee may, at its option, by notice in writing within 10 days after the end of such 60 day period, cancel this Lease, in which event the Parties shall be discharged from all obligations hereunder. If such written notice is not received by Lessor within said 10 day period, Lessee's right to cancel shall terminate. Except as otherwise provided, if possession is not tendered to Lessee by the Commencement Date and Lessee does not terminate this Lease, as aforesaid, any period of rent abatement that Lessee would otherwise have enjoyed shall run from the date of delivery of possession and continue for a period equal to what Lessee would otherwise have enjoyed under the terms hereof, but minus any days of delay caused by the acts or omissions of Lessee. If possession of the Premises

is not delivered within 4 months after the Commencement Date, this Lease shall terminate unless other agreements are reached between Lessor and Lessee, in writing.

3.4 **Lessee Compliance.** Lessor shall not be required to tender possession of the Premises to Lessee until Lessee complies with its obligation to provide evidence of insurance (Paragraph 8.5) Pending delivery of such evidence, Lessee shall be required to perform all of its obligations under this Lease from and after the Start Date, including the payment of Rent, notwithstanding Lessor's election to withhold possession pending receipt of such evidence of insurance. Further, Lessee is required to perform any other conditions prior to or concurrent with the Start Date, the Start Date shall occur but Lessor may elect to withhold possession until such conditions are satisfied.



#### 4 Rent.

4.1 **Rent Defined.** All monetary obligations of Lessee to Lessor under the terms of this Lease (except for the Security Deposit) are deemed to be rent ("**Rent**").

4.2 **Common Area Operating Expenses.** Lessee shall pay to Lessor during the term hereof, in addition to the Base Rent, Lessee's Share (as specified in Paragraph 1.6) of all Common Area Operating Expenses, as hereinafter defined, during each calendar year of the term of this Lease, in accordance with the following provisions:

(a) The following costs relating to the ownership and operation of the Project are defined as "**Common Area Operating Expenses**":

(i) Costs relating to the operation, repair and maintenance, in neat, clean, good order and condition, but not the replacement (see subparagraph (e)), of the following:

(aa) The Common Areas and Common Area improvements, including parking areas, loading and unloading areas, trash areas, roadways, parkways, walkways, driveways, landscaped areas, bumpers, irrigation systems, Common Area lighting facilities, fences and gates, elevators, roofs, and roof drainage systems.

(bb) Exterior signs and any tenant directories.

(cc) Any fire sprinkler systems.

(ii) The cost of water, gas, electricity and telephone to service the Common Areas and any utilities not separately metered.

(iii) The cost of trash disposal, pest control services, property management, security services, owner's association dues and fees, the cost to repaint the exterior of any structures and the cost of any environmental inspections.

(iv) Reserves set aside for maintenance and repair of Common Areas and Common Area equipment.

(v) Any increase above the Base Real Property Taxes (as defined in Paragraph 10).

(vi) Any "Insurance Cost Increase" (as defined in Paragraph 8).

(vii) Any deductible portion of an insured loss concerning the Building or the Common Areas.

(viii) Auditors', accountants' and attorneys' fees and costs related to the operation, maintenance, repair and replacement of the Project.

(ix) The cost of any capital improvement to the Building or the Project not covered and the provisions of Paragraph 2.3 provided; however, that Lessor shall allocate the cost of any such capital improvement over a 12 year period and Lessee shall not be required to pay more than Lessee's Share of 1/144th of the cost of such capital improvement in any given month.

(x) The cost of any other services to be provided by Lessor that are stated elsewhere in this Lease to be a Common Area Operating Expense.

(b) Any Common Area Operating Expenses and Real Property Taxes that are specifically attributable to the Unit, the Building or to any other building in the Project or to the operation, repair and maintenance thereof, shall be allocated entirely to such Unit, Building, or other building. However, any Common Area Operating Expenses and Real Property Taxes that are not specifically attributable to the Building or to any other building or to the operation, repair and maintenance thereof, shall be equitably allocated by Lessor to all buildings in the Project.

(c) The inclusion of the improvements, facilities and services set forth in Subparagraph 4.2(a) shall not be deemed to impose an obligation upon Lessor to either have said improvements or facilities or to provide those services unless the Project already has the same, Lessor already provides the services, or Lessor has agreed elsewhere in this Lease to provide the same or some of them.

(d) Lessee's Share of Common Area Operating Expenses is payable monthly on the same day as the Base Rent is due hereunder. The amount of such payments shall be based on Lessor's estimate of the annual Common Area Operating Expenses. Within 60 days after written request (but not more than once each year) Lessor shall deliver to Lessee a reasonably detailed statement showing Lessee's Share of the actual Common Area Operating Expenses incurred during the preceding year. If Lessee's payments during such year exceed Lessee's Share, Lessor shall credit the amount of such over-payment against Lessee's future payments. If Lessee's payments during such year were less than Lessee's Share, Lessee shall pay to Lessor the amount of the deficiency within 10 days after delivery by Lessor to Lessee of the statement.

(e) Common Area Operating Expenses shall not include the cost of replacing equipment or capital components such as the roof, foundations, exterior walls or Common Area capital improvements, such as the parking lot paving, elevators, fences that have a useful life for accounting purposes of 5 years or more.

(f) Common Area Operating Expenses shall not include any expenses paid by any tenant directly to third parties, or as to which Lessor is otherwise reimbursed by any third party, other tenant, or insurance proceeds.

4.3 **Payment.** Lessee shall cause payment of Rent to be received by Lessor in lawful money of the United States, without offset or deduction (except as specifically permitted in this Lease), on or before the day on which it is due. All monetary amounts shall be rounded to the nearest whole dollar. In the event that any statement or invoice prepared by Lessor is inaccurate such inaccuracy shall not constitute a waiver and Lessee shall be obligated to pay the amount set forth in this Lease Rent for any period during the term hereof which is for less than one full calendar month shall be prorated based upon the actual number of days of said month. Payment of Rent shall be made to Lessor at its address stated herein or to such other persons or place as Lessor may from time to time designate in writing. Acceptance of a payment which is less than the amount then due shall not be a waiver of Lessor's rights to the balance of such Rent, regardless of Lessor's endorsement of any check so stating. In the event that any check, draft, or other instrument of payment given by Lessee to Lessor is dishonored for any reason, Lessee agrees to pay to Lessor the sum of \$25 in addition to any Late Charge and Lessor, at its option, may require all future Rent be paid by cashier's check. Payments will be applied first to accrued late charges and attorney's fees, second to accrued interest, then to Base Rent and Common Area Operating Expenses, and any remaining amount to any other outstanding charges or costs.

5 **Security Deposit.** Lessee shall deposit with Lessor upon execution hereof the Security Deposit as security for Lessee's faithful performance of its obligations under this Lease. If Lessee fails to pay Rent, or otherwise Defaults under this Lease, Lessor may use, apply or retain all or any portion of said Security Deposit for the payment of any amount already due Lessor, for Rents which will be due in the future, and/ or to reimburse or compensate Lessor for any liability, expense, loss or damage which Lessor may suffer or incur by reason thereof. If Lessor uses or applies all or any portion of the Security Deposit, Lessee shall within 10 days after written request therefor deposit monies with Lessor sufficient to restore said Security Deposit to the full amount required by this Lease. If the Base Rent increases during the term of this Lease, Lessee shall, upon written request from Lessor, deposit additional monies with Lessor so that the total amount of the Security Deposit shall at all times bear the same proportion to the increased Base Rent as the initial Security Deposit bore to

the initial Base Rent. Should the Agreed Use be amended to accommodate a material change in the business of Lessee or to accommodate a sublessee or assignee, Lessor shall have the right to increase the Security Deposit to the extent necessary, in Lessor's reasonable judgment, to account for any increased wear and tear that the Premises may suffer as a result thereof. If a change in control of Lessee occurs during this Lease and following such change the financial condition of Lessee is, in Lessor's reasonable judgment, significantly reduced, Lessee shall deposit such additional monies with Lessor as shall be sufficient to cause the Security Deposit to be at a commercially reasonable level based on such change in financial condition. Lessor shall not be required to keep the Security Deposit separate from its general accounts. Within 90 days after the expiration or termination of this Lease, Lessor shall return that portion of the Security Deposit not used or applied by Lessor. No part of the Security Deposit shall be considered to be held in trust, to bear interest or to be prepayment for any monies to be paid by Lessee under this Lease.

6. Use.

6.1 **Use.** Lessee shall use and occupy the Premises only for the Agreed Use, or any other legal use which is reasonably comparable thereto, and for no other purpose. Lessee shall not use or permit the use of the Premises in a manner that is unlawful, creates damage, waste or a nuisance, or that disturbs occupants of or causes damage to neighboring premises or properties. Other than guide, signal and seeing eye dogs, Lessee shall not keep or allow in the Premises any pets, animals, birds, fish, or reptiles. Lessor shall not unreasonably withhold or delay its consent to any written request for a modification of the Agreed Use, so long as the same will not impair the structural integrity of the Building or the mechanical or electrical systems therein, and/or is not significantly more burdensome to the Project. If Lessor elects to withhold consent, Lessor shall within 7 days after such request give written notification of same, which notice shall include an explanation of Lessor's objections to the change in the Agreed Use.

6.2 **Hazardous Substances.**

(a) **Reportable Uses Require Consent.** The term "**Hazardous Substance**" as used in this Lease shall mean any product, substance, or waste whose presence, use, manufacture, disposal, transportation, or release, either by itself or in combination with other materials expected to be on the Premises, is either: (i) potentially injurious to the public health, safety or welfare, the environment or the Premises, (ii) regulated or monitored by any governmental authority, or (iii) a basis for potential liability of Lessor to any governmental agency or third party under any applicable statute or common law theory. Hazardous Substances shall include, but not be limited to, hydrocarbons, petroleum, gasoline, and/or crude oil or any products, by-products or fractions thereof. Lessee shall not engage in any activity in or on the Premises which constitutes a Reportable Use of Hazardous Substances without the express prior written consent of Lessor and timely compliance (at Lessee's expense) with all Applicable Requirements. "**Reportable Use**" shall mean (i) the installation or use of any above or below ground storage tank, (ii) the generation, possession, storage, use, transportation, or disposal of a Hazardous Substance that requires a permit from, or with respect to which a report, notice, registration or business plan is required to be filed with, any governmental authority, and/or (iii) the presence at the Premises of a Hazardous Substance with respect to which any Applicable Requirements requires that a notice be given to persons entering or occupying the Premises or neighboring properties. Notwithstanding the foregoing, Lessee may use any ordinary and customary materials reasonably required to be used in the normal course of the Agreed Use, ordinary office supplies (copier toner, liquid paper, glue, etc.,) and common household cleaning materials, so long as such use is in compliance with all Applicable Requirements, is not a Reportable Use, and does not expose the Premises or neighboring property to any meaningful risk of contamination or damage or expose Lessor to any liability therefor. In addition, Lessor may condition its consent to any Reportable Use upon receiving such additional assurances as Lessor reasonably deems necessary to protect itself, the public, the Premises and/or the environment against damage, contamination, injury and/or liability, including, but not limited to, the installation (and removal on or before Lease expiration or termination) of protective modifications (such as concrete encasements) and/or increasing the Security Deposit.

(b) **Duty to Inform Lessor.** If Lessee knows, or has reasonable cause to believe, that a Hazardous Substance has come to be located in, on, under or about the Premises, other than as previously consented to by Lessor, Lessee shall immediately give written notice of such fact to Lessor, and provide Lessor with a copy of any report, notice, claim or other documentation which it has concerning the presence of such Hazardous Substance.

(c) **Lessee Remediation.** Lessee shall not cause or permit any Hazardous Substance to be spilled or released in, on, under, or about the Premises (including through the plumbing or sanitary sewer system) and shall promptly, at Lessee's expense, comply with all Applicable Requirements and take all investigatory and/or remedial action reasonably recommended, whether or not formally ordered or required, for the cleanup of any contamination of, and for the maintenance, security and/or monitoring of the Premises or neighboring properties, that was caused or materially contributed to by Lessee, or pertaining to or involving any Hazardous Substance brought onto the Premises during the term of this Lease, by or for Lessee, or any third party.

(d) **Lessee Indemnification.** Lessee shall indemnify, defend and hold Lessor, its agents, employees, lenders and ground lessor, if any, harmless from and against any and all loss of rents and/or damages, liabilities, judgments, claims, expenses, penalties, and attorneys' and consultants' fees arising out of or involving any Hazardous Substance brought onto the Premises by or for Lessee, or any third party (provided, however, that Lessee shall have no liability under this Lease with respect to underground migration of any Hazardous Substance under the Premises from areas outside of the Project not caused or contributed to by Lessee). Lessee's obligations shall include, but not be limited to, the effects of any contamination or injury to person, property or the environment created or suffered by Lessee, and the cost of investigation, removal, remediation, restoration and/or abatement, and shall survive the expiration or termination of this Lease. No termination, cancellation or release agreement entered into by Lessor and Lessee shall release Lessee from its obligations under this Lease with respect to Hazardous Substances, unless specifically so agreed by Lessor in writing at the time of such agreement.

(e) **Lessor Indemnification.** Lessor and its successors and assigns shall indemnify, defend, reimburse and hold Lessee, its employees and lenders, harmless from and against any and all environmental damages, including the cost of remediation, which suffered as a direct result of Hazardous Substances on the Premises prior to Lessee taking possession or which are caused by the gross negligence or willful misconduct of Lessor, its agents or employees. Lessor's obligations, as and when required by the Applicable Requirements, shall include, but not be limited to, the cost of investigation, removal, remediation, restoration and/or abatement, and shall survive the expiration or termination of this Lease.

(f) **Investigations and Remediations.** Lessor shall retain the responsibility and pay for any investigations or remediation measures required by governmental entities having jurisdiction with respect to the existence of Hazardous Substances on the Premises prior to Lessee taking possession, unless such remediation measure is required as a result of Lessee's use (including "Alterations", as defined in paragraph 7.3(a) below) of the Premises, in which event Lessee shall be responsible for such payment Lessee shall cooperate fully in any such activities at the request of Lessor, including allowing Lessor and Lessor's agents to have reasonable access to the Premises at reasonable times in order to carry out Lessor's investigative and remedial responsibilities.

(g) **Lessor Termination Option.** If a Hazardous Substance Condition (see Paragraph 9.1(e)) occurs during the term of this Lease, unless Lessee is legally responsible therefor (in which case Lessee shall make the investigation and remediation thereof required by the Applicable Requirements and this Lease shall continue in full force and effect, but subject to Lessor's rights under Paragraph 6.2(d) and Paragraph 13), Lessor may, at Lessor's option, either (i) investigate and remediate such Hazardous Substance Condition, if required, as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) if the estimated cost to remediate such condition exceeds 12 times the then monthly Base Rent or \$100,000, whichever is greater, give written notice to Lessee, within 30 days after receipt by Lessor of knowledge of the occurrence of such Hazardous Substance Condition, of Lessor's desire to terminate this Lease as of the date 60 days following the date of such notice. In the event Lessor elects to give a termination notice, Lessee may, within 10 days thereafter, give written notice to Lessor of Lessee's commitment to pay the amount by which the cost of the remediation of such Hazardous Substance Condition exceeds an amount equal to 12 times the then monthly Base Rent or \$100,000,

whichever is greater. Lessee shall provide Lessor with said funds or satisfactory assurance thereof within 30 days following such commitment. In such event, this Lease shall continue in full force and effect, and Lessor shall proceed to make such remediation as soon as reasonably possible after the required funds are available. If Lessee does not give such notice and provide the required funds or assurance thereof within the time provided, this Lease shall terminate as of the date specified in Lessor's notice of termination.

6.3 **Lessee's Compliance with Applicable Requirements.** Except as otherwise provided in this Lease, Lessee shall, at Lessee's sole expense, fully, diligently and in a timely manner, materially comply with all Applicable Requirements, the requirements of any applicable fire insurance underwriter or rating bureau, and the recommendations of Lessor's engineers and/or consultants which relate in any manner to such Requirements, without regard to whether said Requirements are now in effect or become effective after the Start Date. Lessee shall, within 10 days after receipt of Lessor's written request, provide Lessor with copies of all permits and other documents, and other information evidencing Lessee's compliance with any Applicable Requirements specified by Lessor, and shall immediately upon receipt, notify Lessor in writing (with copies of any documents involved) of any threatened or actual claim, notice, citation, warning, complaint or report pertaining to or involving the failure of Lessee or the Premises to comply with any Applicable Requirements. Likewise, Lessee shall immediately give written notice to Lessor of: (i) any water damage to the Premises and any suspected seepage, pooling, dampness or other condition conducive to the production of mold; or (ii) any mustiness or other odors that might indicate the presence of mold in the Premises.

6.4 **Inspection; Compliance.** Lessor and Lessor's "Lender" (as defined in Paragraph 30) and consultants shall have the right to enter into Premises at any time, in the case of an emergency, and otherwise at reasonable times after reasonable notice, for the purpose of inspecting the condition of the Premises and for verifying compliance by Lessee with this Lease. The cost of any such inspections shall be paid by Lessor, unless a violation of Applicable Requirements, or a Hazardous Substance Condition (see Paragraph 9.1) is found to exist or be imminent, or the inspection is requested or ordered by a governmental authority. In such case, Lessee shall upon request reimburse Lessor for the cost of such inspection, so long as such inspection is reasonably related to the violation or contamination. In addition, Lessee shall provide copies of all relevant material safety data sheets (MSDS) to Lessor within 10 days of the receipt of written request therefor.

7. **Maintenance; Repairs; Utility Installations; Trade Fixtures and Alterations.**

7.1 **Lessee's Obligations.**

(a) **In General.** Subject to the provisions of Paragraph 2.2 (Condition), 2.3 (Compliance), 6.3 (Lessee's Compliance with Applicable Requirements), 7.2 (Lessor's Obligations), 9 (Damage or Destruction), and 14 (Condemnation), Lessee shall, at Lessee's sole expense, keep the Premises, Utility Installations (intended for Lessee's exclusive use, no matter where located), and Alterations in good order, condition and repair (whether or not the portion of the Premises requiring repairs, or the means of repairing the same, are reasonably or readily accessible to Lessee, and whether or not the need for such repairs occurs as a result of Lessee's use, any prior use, the elements or the age of such portion of the Premises), including, but not limited to, all equipment or facilities, such as plumbing, HVAC equipment, electrical, lighting facilities, boilers, pressure vessels, fixtures, interior walls, interior surfaces of exterior walls, ceilings, floors, windows, doors, plate glass, and skylights but excluding any items which are the responsibility of Lessor pursuant to Paragraph 7.2. Lessee, in keeping the Premises in good order, condition and repair, shall exercise and perform good maintenance practices, specifically including the procurement and maintenance of the service contracts required by Paragraph 7.1(b) below. Lessee's obligations shall include restorations, replacements or renewals when necessary to keep the Premises and all improvements thereon or a part thereof in good order, condition and state of repair.

(b) **Service Contracts.** Lessee shall, at Lessee's sole expense, procure and maintain contracts, with copies to Lessor, in customary form and substance for, and with contractors specializing and experienced in the maintenance of the following equipment and improvements, if any, if and when installed on the Premises: (i) HVAC equipment, (ii) boiler and pressure vessels, and (iii) clarifiers. However, Lessor reserves the right, upon notice to Lessee, to procure and maintain any or all of such service contracts, and Lessee shall reimburse Lessor, upon demand, for the cost thereof.

(c) **Failure to Perform.** If Lessee fails to perform Lessee's obligations under this Paragraph 7.1, Lessor may enter upon the Premises after 10 days' prior written notice to Lessee (except in the case of an emergency, in which case no notice shall be required), perform such obligations on Lessee's behalf, and put the Premises in good order, condition and repair, and Lessee shall promptly pay to Lessor a sum equal to 115% of the cost thereof.

(d) **Replacement.** Subject to Lessee's indemnification of Lessor as set forth in Paragraph 8.7 below, and without relieving Lessee of liability resulting from Lessee's failure to exercise and perform good maintenance practices, if an item described in Paragraph 7.1(b) cannot be repaired other than at a cost which is in excess of 50% of the cost of replacing such item, then such item shall be replaced by Lessor, and the cost thereof shall be prorated between the Parties and Lessee shall only be obligated to pay, each month during the remainder of the term of this Lease, on the date on which Base Rent is due, an amount equal to the product of multiplying the cost of such replacement by a fraction, the numerator of which is one, and the denominator of which is 144 (ie.1/144th of the cost per month). Lessee shall pay Interest on the unamortized balance but may prepay its obligation at any time.

7.2 **Lessor's Obligations.** Subject to the provisions of Paragraphs 2.2 (Condition), 2.3 (Compliance), 4.2 (Common Area Operating Expenses), 6 (Use), 7.1 (Lessee's Obligations), 9 (Damage or Destruction) and 14 (Condemnation), Lessor, subject to reimbursement pursuant to Paragraph 4.2, shall keep in good order, condition and repair the foundations, exterior walls, structural condition of interior bearing walls, exterior roof, fire sprinkler system, Common Area fire alarm and/or smoke detection systems, fire hydrants, parking lots, walkways, parkways, driveways, landscaping, fences, signs and utility systems serving the Common Areas and all parts thereof, as well as providing the services for which there is a Common Area Operating Expense pursuant to Paragraph 4.2. Lessor shall not be obligated to paint the exterior or interior surfaces of exterior walls nor shall Lessor be obligated to maintain, repair or replace windows, doors or plate glass of the Premises. Lessee expressly waives the benefit of any statute now or hereafter in effect to the extent it is inconsistent with the terms of this Lease.

7.3 **Utility Installations; Trade Fixtures; Alterations.**

(a) **Definitions.** The term "Utility Installations" refers to all floor and window coverings, air and/or vacuum lines, power panels, electrical distribution, security and fire protection systems, communication cabling, lighting fixtures, HVAC equipment, plumbing, and fencing in or on the Premises. The term "**Trade Fixtures**" shall mean Lessee's machinery and equipment that can be removed without doing material damage to the Premises. The term "**Alterations**" shall mean any modification of the improvements, other than Utility Installations or Trade Fixtures, whether by addition or deletion "**Lessee Owned Alterations and/or Utility Installations**" are defined as Alterations and/or Utility Installations made by Lessee that are not *yet* owned by Lessor pursuant to Paragraph 7.4(a).

(b) **Consent.** Lessee shall not make any Alterations or Utility Installations to the Premises without Lessor's prior written consent. Lessee may, however, make non-structural Alterations or Utility Installations to the interior of the Premises (excluding the roof) without such consent but upon notice to Lessor, as long as they are not visible from the outside, do not involve puncturing, relocating or removing the roof or any existing walls, will not affect the electrical, plumbing, HVAC, and/or life safety systems, and the cumulative cost thereof during this Lease as extended does not exceed a sum equal to 3 month's Base Rent in the aggregate or a sum equal to one month's Base Rent in any one year. Notwithstanding the foregoing, Lessee shall not make or permit any roof penetrations and/or install anything on the roof without the prior written approval of Lessor. Lessor may, as a precondition to granting such approval, require Lessee to utilize a contractor chosen and/or approved by Lessor Any Alterations or Utility Installations that Lessee shall desire to make and which require the consent of the Lessor shall be presented to Lessor in written form with detailed plans. Consent shall be deemed conditioned upon Lessee's: (i) acquiring all applicable governmental permits, (ii) furnishing Lessor with copies of both the permits and the plans and specifications prior to commencement of the work, and (iii) compliance with all conditions of said permit and other Applicable Requirements in a prompt and expeditious manner. Any Alterations or Utility Installations shall be performed in a workmanlike manner with good and sufficient materials. Lessee shall promptly upon completion furnish Lessor with as-built plans and specifications. For work which costs an amount in excess of one month's Base Rent, Lessor may condition its consent upon Lessee providing a lien and completion bond in an amount equal to 150% of the estimated cost of such Alteration of Utility installation and/or upon Lessee's posting an additional Security Deposit with Lessor.



(c) **Liens; Bonds.** Lessee shall pay, when due, all claims for labor or materials furnished or alleged to have been furnished to or for Lessee at or for use on the Premises, which claims are or may be secured by any mechanic's or materialmen's lien against the Premises or any interest therein. Lessee shall give Lessor not less than 10 days' notice prior to the commencement of any work in, on or about the Premises, and Lessor shall have the right to post notices of non-responsibility. If Lessee shall contest the validity of any such lien, claim or demand, then Lessee shall, at its sole expense defend and protect itself, Lessor and the Premises against the same and shall pay and satisfy any such adverse judgment that may be rendered thereon before the enforcement thereof. If Lessor shall require, Lessee shall furnish a surety bond in an amount equal to 150% of the amount of such contested lien, claim or demand, indemnifying Lessor against liability for the same. If Lessor elects to participate in any such action, Lessee shall pay Lessor's attorneys' fees and costs.

#### 7.4 **Ownership; Removal; Surrender; and Restoration.**

(a) **Ownership.** Subject to Lessor's right to require removal or elect ownership as hereinafter provided, all Alterations and Utility Installations made by Lessee shall be the property of Lessee, but considered a part of the Premises. Lessor may, at any time, elect in writing to be the owner of all or any specified part of the Lessee Owned Alterations and Utility Installations. Unless otherwise instructed per paragraph 7.4(b) hereof, all Lessee Owned Alterations and Utility Installations shall, at the expiration or termination of this Lease, become the property of Lessor and be surrendered by Lessee with the Premises.

(b) **Removal.** By delivery to Lessee of written notice from Lessor not earlier than 90 and not later than 30 days prior to the end of the term of this Lease, Lessor may require that any or all Lessee Owned Alterations or Utility Installations be removed by the expiration or termination of this Lease. Lessor may require the removal at any time of all or any part of any Lessee Owned Alterations or Utility Installations made without the required consent.

(c) **Surrender; Restoration.** Lessee shall surrender the Premises by the Expiration Date or any earlier termination date, with all of the improvements, parts and surfaces thereof broom clean and free of debris, and in good operating order, condition and state of repair, ordinary wear and tear excepted. "Ordinary wear and tear" shall not include any damage or deterioration that would have been prevented by good maintenance practice. Notwithstanding the foregoing, if this Lease is for 12 months or less, then Lessee shall surrender the Premises in the same condition as delivered to Lessee on the Start Date with NO allowance for ordinary wear and tear. Lessee shall repair any damage occasioned by the installation, maintenance or removal of Trade Fixtures, Lessee owned Alterations and/or Utility Installations, furnishings, and equipment as well as the removal of any storage tank installed by or for Lessee. Lessee shall also completely remove from the Premises any and all Hazardous Substances brought onto the Premises by or for Lessee, or any third party (except Hazardous Substances which were deposited via underground migration from areas outside of the Premises) even if such removal would require Lessee to perform or pay for work that exceeds statutory requirements. Trade Fixtures shall remain the property of Lessee and shall be removed by Lessee. Any personal property of Lessee not removed on or before the Expiration Date or any earlier termination date shall be deemed to have been abandoned by Lessee and may be disposed of or retained by Lessor as Lessor may desire. The failure by Lessee to timely vacate the Premises pursuant to this Paragraph 7.4(c) without the express written consent of Lessor shall constitute a holdover under the provisions of Paragraph 26 below.

#### 8. **Insurance; Indemnity.**

##### 8.1 **Payment of Premium Increases.**

(a) As used herein, the term "**Insurance Cost Increase**" is defined as any increase in the actual cost of the insurance applicable to the Building and/or the Project and required to be carried by Lessor, pursuant to Paragraphs 8.2(b), 8.3(a) and 8.3(b), ("**Required Insurance**"), over and above the Base Premium, as hereinafter defined, calculated on an annual basis. Insurance Cost Increase shall include, but not be limited to, requirements of the holder of a mortgage or deed of trust covering the Premises, Building and/or Project, increased valuation of the Premises, Building and/or Project, and/or a general premium rate increase. The term Insurance Cost Increase shall not, however, include any premium increases resulting from the nature of the occupancy of any other tenant of the Building. The "**Base Premium**" shall be the annual premium applicable to the 12 month period immediately preceding the Start Date. If, however, the Project was not insured for the entirety of such 12 month period, then the Base Premium shall be the lowest annual premium reasonably obtainable for the Required Insurance as of the Start Date, assuming the most nominal use possible of the Building. In no event, however, shall Lessee be responsible for any portion of the premium cost attributable to liability insurance coverage in excess of \$2,000,000 procured under Paragraph 8.2(b).

(b) Lessee shall pay any Insurance Cost Increase to Lessor pursuant to Paragraph 4. 2. Premiums for policy periods commencing prior to, or extending beyond, the term of this Lease shall be prorated to coincide with the corresponding Start Date or Expiration Date.

##### 8.2 **Liability Insurance.**

(a) **Carried by Lessee.** Lessee shall obtain and keep in force a Commercial General Liability policy of insurance protecting Lessee and Lessor as an additional insured against claims for bodily injury, personal injury and property damage based upon or arising out of the ownership, use, occupancy or maintenance of the Premises and all areas appurtenant thereto. Such insurance shall be on an occurrence basis providing single limit coverage in an amount not less than \$1,000,000 per occurrence with an annual aggregate of not less than \$2,000,000. Lessee shall add Lessor as an additional insured by means of an endorsement at least as broad as the Insurance Service Organization's "Additional Insured-Managers or Lessor's of Premises" Endorsement. The policy shall not contain any intra-insured exclusions as between insured persons or organizations, but shall include coverage for liability assumed under this Lease as an "**insured contract**" for the performance of Lessee's indemnity obligations under this Lease. The limits of said insurance shall not, however, limit the liability of Lessee nor relieve Lessee of any obligation hereunder. Lessee shall provide an endorsement on its liability policy(ies) which provides that its insurance shall be primary to and not contributory with any similar insurance carried by Lessor, whose insurance shall be considered excess insurance only.

(b) **Carried by Lessor.** Lessor shall maintain liability insurance as described in Paragraph 8.2(a), in addition to, and not in lieu of, the insurance required to be maintained by Lessee. Lessee shall not be named as an additional insured therein.

##### 8.3 **Property Insurance- Building, Improvements and Rental Value.**

(a) **Building and Improvements.** Lessor shall obtain and keep in force a policy or policies of insurance in the name of Lessor, with loss payable to Lessor, any ground-lessor, and to any Lender insuring loss or damage to the Premises. The amount of such insurance shall be equal to the full insurable replacement cost of the Premises, as the same shall exist from time to time, or the amount required by any Lender, but in no event more than the commercially reasonable and available insurable value thereof, Lessee Owned Alterations and Utility Installations, Trade Fixtures, and Lessee's personal property shall be insured by Lessee not by Lessor. If the coverage is available and commercially appropriate, such policy or policies shall insure against all risks of direct physical loss or damage (except the perils of flood and/or earthquake unless required by a Lender), including coverage for debris removal and the enforcement of

any Applicable Requirements requiring the upgrading, demolition, reconstruction or replacement of any portion of the Premises as the result of a covered loss. Said policy or policies shall also contain an agreed valuation provision in lieu of any coinsurance clause, waiver of subrogation, and inflation guard protection causing an increase in the annual property insurance coverage amount by a factor of not less than the adjusted U. S. Department of Labor Consumer Price Index for All Urban Consumers for the city nearest to where the Premises are located. If such insurance coverage has a deductible clause, the deductible amount shall not exceed \$1,000 per occurrence.

(b) **Rental Value.** Lessor shall also obtain and keep in force a policy or policies in the name of Lessor with loss payable to Lessor and any Lender, insuring the loss of the full Rent for one year with an extended period of indemnity for an additional 180 days ("Rental Value Insurance"). Said insurance shall contain an agreed valuation provision in lieu of any coinsurance clause, and the amount of coverage shall be adjusted annually to reflect the projected Rent otherwise payable by Lessee, for the next 12 month period.



(c) **Adjacent Premises.** Lessee shall pay for any increase in the premiums for the property insurance of the Building and for the Common Areas or other buildings in the Project if said increase is caused by Lessee's acts, omissions, use or occupancy of the Premises.

(d) **Lessee's Improvements.** Since Lessor is the Insuring Party, Lessor shall not be required to insure Lessee Owned Alterations and Utility Installations unless the item in question has become the property of Lessor under the terms of this Lease.

#### 8.4 **Lessee's Property; Business Interruption Insurance.**

(a) **Property Damage.** Lessee shall obtain and maintain insurance coverage on all of Lessee's personal property, Trade Fixtures, and Lessee Owned Alterations and Utility Installations. Such insurance shall be full replacement cost coverage with a deductible of not to exceed \$1,000 per occurrence. The proceeds from any such insurance shall be used by Lessee for the replacement of personal property, Trade Fixtures and Lessee Owned Alterations and Utility Installations, Lessee shall provide Lessor with written evidence that such insurance is in force.

(b) **Business Interruption.** Lessee shall obtain and maintain loss of income and extra expense insurance in amounts as will reimburse Lessee for direct or indirect loss of earnings attributable to all perils commonly insured against by prudent lessees in the business of Lessee or attributable to prevention of access to the Premises as a result of such perils.

(c) **No Representation of Adequate Coverage.** Lessor makes no representation that the limits or forms of coverage of insurance specified herein are adequate to cover Lessee's property, business operations or obligations under this Lease.

8.5 **Insurance Policies.** Insurance required herein shall be by companies duly licensed or admitted to transact business in the state where the Premises are located, and maintaining during the policy term a "General Policyholders Rating" of at least A-VI, as set forth in the most current issue of "Best's Insurance Guide", or such other rating as may be required by a Lender. Lessee shall not do or permit to be done anything which invalidates the required insurance policies. Lessee shall, prior to the Start Date, deliver to Lessor certified copies of policies of such insurance or certificates evidencing the existence and amounts of the required insurance. No such policy shall be cancelable or subject to modification except after 30 days prior written notice to Lessor. Lessee shall, at least 10 days prior to the expiration of such policies, furnish Lessor with evidence of renewals or "insurance binders" evidencing renewal thereof, or Lessor may order such insurance and charge the cost thereof to Lessee, which amount shall be payable by Lessee to Lessor upon demand. Such policies shall be for a term of at least one year, or the length of the remaining term of this Lease, whichever is less if either Party shall fail to procure and maintain the insurance required to be carried by it, the other Party may, but shall not be required to, procure and maintain the same.

8.6 **Waiver of Subrogation.** Without affecting any other rights or remedies, Lessee and Lessor each hereby release and relieve the other, and waive their entire right to recover damages against the other, for loss of or damage to its property arising out of or incident to the perils required to be insured against herein. The effect of such releases and waivers is not limited by the amount of insurance carried or required, or by any deductibles applicable hereto. The Parties agree to have their respective property damage insurance carriers waive any right to subrogation that such companies may have against Lessor or Lessee, as the case may be, so long as the insurance is not invalidated thereby.

8.7 **Indemnity.** Except for Lessor's gross negligence or willful misconduct, Lessee shall indemnify, protect, defend and hold harmless the Premises, Lessor and its agents. Lessor's master or ground lessor, partners and Lenders, from and against any and all claims, loss of rents and/or damages, liens, judgments, penalties, attorneys' and consultants' fees, expenses and/or liabilities arising out of, involving, or in connection with, the use and/or occupancy of the Premises by Lessee. If any action or proceeding is brought against Lessor by reason of any of the foregoing matters, Lessee shall upon notice defend the same at Lessee's expense by counsel reasonably satisfactory to Lessor and Lessor shall cooperate with Lessee in such defense, Lessor need not have first paid any such claim in order to be defended or indemnified.

8.8 **Exemption of Lessor and its Agents from Liability.** Notwithstanding the negligence or breach of this Lease by Lessor or its agents, neither Lessor nor its agents shall be liable under any circumstances for: (i) injury or damage to the person or goods, wares, merchandise or other property of Lessee, Lessee's employees, contractors, invitees, customers, or any other person in or about the Premises, whether such damage or injury is caused by or results from fire, steam, electricity, gas, water or rain, indoor air quality, the presence of mold or from the breakage, leakage, obstruction or other defects of pipes, fire sprinklers, wires, appliances, plumbing, HVAC or lighting fixtures, or from any other cause, whether the said injury or damage results from conditions arising upon the Premises or upon other portions of the Building, or from other sources or places, (ii) any damages arising from any act or neglect of any other tenant of Lessor or from the failure of Lessor or its agents to enforce the provisions of any other lease in the Project, or (iii) injury to Lessee's business or for any loss of income or profit therefrom. Instead, it is intended that Lessee's sole recourse in the event of such damages or injury be to file a claim on the insurance policy(ies) that Lessee is required to maintain pursuant to the provisions of paragraph 8.

8.9 **Failure to Provide Insurance.** Lessee acknowledges that any failure on its part to obtain or maintain the insurance required herein will expose Lessor to risks and potentially cause Lessor to incur costs not contemplated by this Lease, the extent of which will be extremely difficult to ascertain. Accordingly, for any month or portion thereof that Lessee does not maintain the required insurance and/or does not provide Lessor with the required binders or certificates evidencing the existence of the required insurance, the Base Rent shall be automatically increased, without any requirement for notice to Lessee, by an amount equal to 10% of the then existing Base Rent or \$100, whichever is greater. The parties agree that such increase in Base Rent represents fair and reasonable compensation for the additional risk/costs that Lessor will incur by reason of Lessee's failure to maintain the required insurance. Such increase in Base Rent shall in no event constitute a waiver of Lessee's Default or Breach with respect to the failure to maintain such insurance, prevent the exercise of any of the other rights and remedies granted hereunder, nor relieve Lessee of its obligation to maintain the insurance specified in this Lease.

## 9. **Damage or Destruction.**

### 9.1 **Definitions.**

(a) **"Premises Partial Damage"** shall mean damage or destruction to the improvements on the Premises, other than Lessee Owned Alterations and Utility Installations, which can reasonably be repaired in 3 months or less from the date of the damage or destruction, and the cost thereof does not exceed a sum equal to 6 month's Base Rent. Lessor shall notify Lessee in writing within 30 days from the date of the damage or destruction as to whether or not the damage is Partial or Total. Notwithstanding the foregoing, Premises Partial Damage shall not include damage to windows, doors, and/or other similar items which Lessee has the responsibility to repair or replace pursuant to the provisions of Paragraph 7.1.

(b) **"Premises Total Destruction"** shall mean damage or destruction to the improvements on the Premises, other than Lessee Owned Alterations and Utility Installations and Trade Fixtures, which cannot reasonably be repaired in 3 months or less from the date of the damage or destruction and/or the cost thereof exceeds a sum equal to 6 month's Base Rent. Lessor shall notify Lessee in writing within 30 days from the date of the damage or destruction as to whether or not the damage is Partial or Total.

( c ) **"Insured Loss"** shall mean damage or destruction to improvements on the Premises, other than Lessee Owned Alterations and Utility Installations and Trade Fixtures, which was caused by an event required to be covered by the insurance described in Paragraph 8.3(a), irrespective of any deductible amounts or coverage limits involved.

( d ) **"Replacement Cost"** shall mean the cost to repair or rebuild the improvements owned by Lessor at the time of the occurrence to their condition existing immediately prior thereto, including demolition, debris removal and upgrading required by the operation of Applicable Requirements, and without deduction for depreciation.

(e) **"Hazardous Substance Condition"** shall mean the occurrence or discovery of a condition involving the presence of, or a contamination by, a Hazardous Substance, in, on, or under the Premises which requires restoration.

9.2 **Partial Damage - Insured Loss.** If a Premises Partial Damage that is an Insured Loss occurs, then Lessor shall, at Lessor's expense, repair such damage (but not Lessee's Trade Fixtures or Lessee Owned Alterations and Utility Installations) as soon as reasonably possible and this Lease shall continue in full force and effect; provided, however, that Lessee shall, at Lessor's election, make the repair of any damage or destruction the total cost to repair of which is \$10,000 or less, and, in such event, Lessor shall make any applicable insurance proceeds available to Lessee on a reasonable basis for that purpose. Notwithstanding the foregoing, if the required insurance was not in force or the insurance proceeds are not sufficient to effect such repair, the Insuring Party shall promptly contribute the shortage in proceeds as and when required to complete said repairs. In the event, however, such shortage was due to the fact that, by reason of the unique nature of the improvements, full replacement cost insurance coverage was not commercially reasonable and available, Lessor shall have no obligation to pay for the shortage in insurance proceeds or to fully restore the unique aspects of the Premises unless Lessee provides Lessor with the funds to cover same, or adequate assurance thereof, within 10 days following receipt of written notice of such shortage and request therefor. If Lessor receives said funds or adequate assurance thereof within said 10 day period, the party responsible for making the repairs shall complete them as soon as reasonably possible and this Lease shall remain in full force and effect. If such funds or assurance are not received, Lessor may nevertheless elect by written notice to Lessee within 10 days thereafter to: (i) make such restoration and repair as is commercially reasonable with Lessor paying any shortage in proceeds, in which case this Lease shall remain in full force and effect, or (ii) have this Lease terminate 30 days thereafter. Lessee shall not be entitled to reimbursement of any funds contributed by Lessee to repair any such damage or destruction. Premises Partial Damage due to flood or earthquake shall be subject to Paragraph 9.3, notwithstanding that there may be some insurance coverage, but the net proceeds of any such insurance shall be made available for the repairs if made by either Party.

9.3 **Partial Damage - Uninsured Loss.** If a Premises Partial Damage that is not an Insured Loss occurs, unless caused by a negligent or willful act of Lessee (in which event Lessee shall make the repairs at Lessee's expense), Lessor may either: (i) repair such damage as soon as reasonably possible at Lessor's expense, in which event this Lease shall continue in full force and effect, or (ii) terminate this Lease by giving written notice to Lessee within 30 days after receipt by Lessor of knowledge of the occurrence of such damage. Such termination shall be effective 60 days following the date of such notice. In the event Lessor elects to terminate this Lease, Lessee shall have the right within 10 days after receipt of the termination notice to give written notice to Lessor of Lessee's commitment to pay for the repair of such damage without reimbursement from Lessor. Lessee shall provide Lessor with said funds or satisfactory assurance thereof within 30 days after making such commitment. In such event this Lease shall continue in full force and effect, and Lessor shall proceed to make such repairs as soon as reasonably possible after the required funds are available. If Lessee does not make the required commitment, this Lease shall terminate as of the date specified in the termination notice.

9.4 **Total Destruction.** Notwithstanding any other provision hereof, if a Premises Total Destruction occurs, this Lease shall terminate 60 days following such Destruction. If the damage or destruction was caused by the gross negligence or willful misconduct of Lessee, Lessor shall have the right to recover Lessor's damages from Lessee, except as provided in Paragraph 8.6.

9.5 **Damage Near End of Term.** If at any time during the last 6 months of this Lease there is damage for which the cost to repair exceeds one month's Base Rent, whether or not an Insured Loss, Lessor may terminate this Lease effective 60 days following the date of occurrence of such damage by giving a written termination notice to Lessee within 30 days after the date of occurrence of such damage. Notwithstanding the foregoing, if Lessee at that time has an exercisable option to extend this Lease or to purchase the Premises, then Lessee may preserve this Lease by, (a) exercising such option and (b) providing Lessor with any shortage in insurance proceeds (or adequate assurance thereof) needed to make the repairs on or before the earlier of (i) the date which is 10 days after Lessee's receipt of Lessor's written notice purporting to terminate this Lease, or (ii) the day prior to the date upon which such option expires. If Lessee duly exercises such option during such period and provides Lessor with funds (or adequate assurance thereof) to cover any shortage in insurance proceeds, Lessor shall, at Lessor's commercially reasonable expense, repair such damage as soon as reasonably possible and this Lease shall continue in full force and effect. If Lessee fails to exercise such option and provide such funds or assurance during such period, then this Lease shall terminate on the date specified in the termination notice and Lessee's option shall be extinguished.

#### 9.6 **Abatement of Rent; Lessee's Remedies.**

(a) **Abatement.** In the event of Premises Partial Damage or Premises Total Destruction or a Hazardous Substance Condition for which Lessee is not responsible under this Lease, the Rent payable by Lessee for the period required for the repair, remediation or restoration of such damage shall be abated in proportion to the degree to which Lessee's use of the Premises is impaired, but not to exceed the proceeds received from the Rental Value insurance. All other obligations of Lessee hereunder shall be performed by Lessee, and Lessor shall have no liability for any such damage, destruction, remediation, repair or restoration except as provided herein.

(b) **Remedies.** If Lessor is obligated to repair or restore the Premises and does not commence, in a substantial and meaningful way, such repair or restoration within 90 days after such obligation shall accrue, Lessee may, at any time prior to the commencement of such repair or restoration, give written notice to Lessor and to any Lenders of which Lessee has actual notice, of Lessee's election to terminate this Lease on a date not less than 60 days following the giving of such notice. If Lessee gives such notice and such repair or restoration is not commenced within 30 days thereafter, this Lease shall terminate as of the date specified in said notice. If the repair or restoration is commenced within such 30 days, this Lease shall continue in full force and effect. "Commence" shall mean either the unconditional authorization of the preparation of the required plans, or the beginning of the actual work on the Premises, whichever first occurs.

9.7 **Termination; Advance Payments.** Upon termination of this Lease pursuant to Paragraph 6.2(g) or Paragraph 9, an equitable adjustment shall be made concerning advance Base Rent and any other advance payments made by Lessee to Lessor. Lessor shall, in addition, return to Lessee so much of Lessee's Security Deposit as has not been, or is not then required to be, used by Lessor.

## 10. **Real Property Taxes.**

### 10.1 **Definitions.**

(a) **"Real Property Taxes."** As used herein, the term **"Real Property Taxes"** shall include any form of assessment; real estate, general, special, ordinary or extraordinary, or rental levy or tax (other than inheritance, personal income or estate taxes); improvement bond; and/or license fee imposed upon or levied against any legal or equitable interest of Lessor in the Project, Lessor's right to other income therefrom, and/or Lessor's business of leasing, by any authority having the direct or indirect power to tax and where the funds are generated with reference to the Project address and where the proceeds so generated are to be applied by the city, county or other local taxing authority of a jurisdiction within which the Project is located. The term **"Real Property Taxes"** shall also include any tax, fee, levy, assessment or charge, or any increase therein: (i) imposed by reason of events occurring during the term of this Lease, including but not limited to, a change in the ownership of the Project, (ii) a change in the improvements thereon, and/or (iii) levied or assessed on

machinery or equipment provided by Lessor to Lessee pursuant to this Lease.

( b ) **"Base Real Property Taxes."** As used herein, the term **"Base Real Property Taxes"** shall be the amount of Real Property Taxes, which are assessed against the Premises, Building, Project or Common Areas in the calendar year during which the Lease is executed. In calculating Real Property Taxes for any calendar year, the Real Property Taxes for any real estate tax year shall be included in the calculation of Real Property Taxes for such calendar year based upon the number of days which such calendar year and tax year have in common.

10.2 **Payment of Taxes.** Except as otherwise provided in Paragraph 10.3, Lessor shall pay the Real Property Taxes applicable to the Project, and said payments shall be included in the calculation of Common Area Operating Expenses in accordance with the provisions of Paragraph 4.2.

10.3 **Additional Improvements.** Common Area Operating Expenses shall not include Real Property Taxes specified in the tax assessor's records and work sheets as being caused by additional improvements placed upon the Project by other tenants or by Lessor for the exclusive enjoyment of such other Tenants Notwithstanding Paragraph 10.2 hereof, Lessee shall, however, pay to Lessor at the time Common Area Operating Expenses are payable under Paragraph 4.2, the entirety of any increase in Real Property Taxes if assessed solely by reason of Alterations, Trade Fixtures or Utility Installations placed upon the Premises by Lessee or at Lessee's request or by reason of any alterations or improvements to the Premises made by Lessor subsequent to the execution of this Lease by the Parties.

10.4 **Joint Assessment.** If the Building is not separately assessed, Real Property Taxes allocated to the Building shall be an equitable proportion of the Real Property Taxes for all of the land and improvements included within the tax parcel assessed, such proportion to be determined by Lessor from the respective valuations assigned in the assess of work sheets or such other information as may be reasonably available Lessor's reasonable determination thereof, in good faith, shall be conclusive.

10.5 **Personal Property Taxes.** Lessee shall pay prior to delinquency all taxes assessed against and levied upon Lessee Owned Alterations and Utility Installations, Trade Fixtures, furnishings, equipment and all personal property of Lessee contained in the Premises. When possible, Lessee shall cause its Lessee Owned Alterations and Utility Installations, Trade Fixtures, furnishings, equipment and all other personal property to be assessed and billed separately from the real property of Lessor. If any of Lessee's said property shall be assessed with Lessor's real property, Lessee shall pay Lessor the taxes attributable to Lessee's property within 10 days after receipt of a written statement setting forth the taxes applicable to Lessee's property.

11. **Utilities and Services.** Lessee shall pay for all water, gas, heat, light, power, telephone, trash disposal and other utilities and services supplied to the Premises, together with any taxes thereon. Notwithstanding the provisions of Paragraph 4.2, if at any time in Lessor's sole judgment, Lessor determines that Lessee is using a disproportionate amount of water, electricity or other commonly metered utilities, or that Lessee is generating such a large volume of trash as to require an increase in the size of the trash receptacle and/or an increase in the number of times per month that it is emptied, then Lessor may increase Lessee's Base Rent by an amount equal to such increased costs. There shall be no abatement of Rent and Lessor shall not be liable in any respect whatsoever for the inadequacy, stoppage, interruption or discontinuance of any utility or service due to riot, strike, labor dispute, breakdown, accident, repair or other cause beyond Lessor's reasonable control or in cooperation with governmental request or directions.

## 12. **Assignment and Subletting.**

### 12.1 **Lessor's Consent Required.**

(a) Lessee shall not voluntarily or by operation of law assign, transfer, mortgage or encumber (collectively, "**assign or assignment**") or sublet all or any part of Lessee's interest in this Lease or in the Premises without Lessor's prior written consent.

(b) Unless Lessee is a corporation and its stock is publicly traded on a national stock exchange, a change in the control of Lessee shall constitute an assignment requiring consent. The transfer, on a cumulative basis, of 25% or more of the voting control of Lessee shall constitute a change in control for this purpose.

(c) The involvement of Lessee or its assets in any transaction, or series of transactions (by way of merger, sale, acquisition, Financing, transfer, leveraged buy-out or otherwise), whether or not a formal assignment or hypothecation of this Lease or Lessee's assets occurs, which results or will result in a reduction of the Net Worth of Lessee by an amount greater than 25% of such Net Worth as it was represented at the time of the execution of this Lease or at the time of the most recent assignment to which Lessor has consented, or as it exists immediately prior to said transaction or transactions constituting such reduction, whichever was or is greater, shall be considered an assignment of this Lease to which Lessor may withhold its consent. "**Net Worth of Lessee**" shall mean the net worth of Lessee (excluding any guarantors) established under generally accepted accounting principles.

(d) An assignment or subletting without consent shall, at Lessor's option, be a Default curable after notice per Paragraph 13.1(c), or a noncurable Breach without the necessity of any notice and grace period. If Lessor elects to treat such unapproved assignment or subletting as a noncurable Breach, Lessor may either: (i) terminate this Lease, or (ii) upon 30 days written notice, increase the monthly Base Rent to 110% of the Base Rent then in effect. Further, in the event of such Breach and rental adjustment, (i) the purchase price of any option to purchase the Premises held by Lessee shall be subject to similar adjustment to 110% of the price previously in effect, and (ii) all fixed and non-fixed rental adjustments scheduled during the remainder of the Lease term shall be increased to 110% of the scheduled adjusted rent.

(e) Lessee's remedy for any breach of Paragraph 12.1 by Lessor shall be limited to compensatory damages and/or injunctive relief.

(f) Lessor may reasonably withhold consent to a proposed assignment or subletting if Lessee is in Default at the time consent is requested.

(g) Notwithstanding the foregoing, allowing a de minimis portion of the Premises, ie. 20 square feet or less, to be used by a third party vendor in connection with the installation of a vending machine or payphone shall not constitute a subletting.

### 12.2 **Terms and Conditions Applicable to Assignment and Subletting.**

(a) Regardless of Lessor's consent, no assignment or subletting shall: (i) be effective without the express written assumption by such assignee or sublessee of the obligations of Lessee under this Lease, (ii) release Lessee of any obligations hereunder, or (iii) alter the primary liability of Lessee for the payment of Rent or for the performance of any other obligations to be performed by Lessee.

(b) Lessor may accept Rent or performance of Lessee's obligations from any person other than Lessee pending approval or disapproval of an assignment. Neither a delay in the approval or disapproval of such assignment nor the acceptance of Rent or performance shall constitute a waiver or estoppel of Lessor's right to exercise its remedies for Lessee's Default or Breach.

(c) Lessor's consent to any assignment or subletting shall not constitute a consent to any subsequent assignment or subletting.

(d) In the event of any Default or Breach by Lessee, Lessor may proceed directly against Lessee, any Guarantors or anyone else responsible for the performance of Lessee's obligations under this Lease, including any assignee or sublessee, without first exhausting Lessor's remedies against any other person or entity responsible therefor to Lessor, or any security held by Lessor.

(e) Each request for consent to an assignment or subletting shall be in writing, accompanied by information relevant to Lessor's determination as to the financial and operational responsibility and appropriateness of the proposed assignee or sublessee, including but not limited to the intended use and/or required modification of the Premises, if any, together with a fee of \$500 as consideration for Lessor's considering and processing said request. Lessee agrees to provide Lessor with such other or additional information and/or documentation as may be reasonably requested. (See also Paragraph 36)

(f) Any assignee of, or sublessee under, this Lease shall, by reason of accepting such assignment, entering into such sublease, or entering into possession of the Premises or any portion thereof, be deemed to have assumed and agreed to conform and comply with each and every term, covenant, condition and obligation herein to be observed or performed by Lessee during the term of said assignment or sublease, other than such obligations as are contrary to or inconsistent with provisions of an assignment or sublease to which Lessor has

specifically consented to in writing.

(g) Lessor's consent to any assignment or subletting shall not transfer to the assignee or sublessee any Option granted to the original Lessee by this Lease unless such transfer is specifically consented to by Lessor in writing, (See Paragraph 39.2)

12.3 **Additional Terms and Conditions Applicable to Subletting.** The following terms and conditions shall apply to any subletting by Lessee of all or any part of the Premises and shall be deemed included in all subleases under this Lease whether or not expressly incorporated therein:

(a) Lessee hereby assigns and transfers to Lessor all of Lessee's interest in all Rent payable on any sublease, and Lessor may collect such Rent and apply same toward Lessee's obligations under this Lease; provided, however, that until a Breach shall occur in the performance of Lessee's obligations, Lessee may collect said Rent. In the event that the amount collected by Lessor exceeds Lessee's then outstanding obligations any such excess shall be refunded to Lessee. Lessor shall not, by reason of the foregoing or any assignment of such sublease, nor by reason of the collection of Rent, be deemed liable to the sublessee for any failure of Lessee to perform and comply with any of Lessee's obligations to such sublessee. Lessee hereby irrevocably authorizes and directs any such sublessee, upon receipt of a written notice from Lessor stating that a Breach exists in the performance of Lessee's obligations under this Lease, to pay to Lessor all Rent due and to become due under the sublease. Sublessee shall rely upon any such notice from Lessor and shall pay all Rents to Lessor without any obligation or right to inquire as to whether such Breach exists, notwithstanding any claim from Lessee to the contrary.

(b) In the event of a Breach by Lessee, Lessor may, at its option, require sublessee to atorn to Lessor, in which event Lessor shall undertake the obligations of the sublessor under such sublease from the time of the exercise of said option to the expiration of such sublease; provided, however, Lessor shall not be liable for any prepaid rents or security deposit paid by such sublessee to such sublessor or for any prior Defaults or Breaches of such sublessor.

(c) Any matter requiring the consent of the sublessor under a sublease shall also require the consent of Lessor.

(d) No sublessee shall further assign or sublet all or any part of the Premises without Lessor's prior written consent.

(e) Lessor shall deliver a copy of any notice of Default or Breach by Lessee to the sublessee, who shall have the right to cure the Default of Lessee within the grace period, if any, specified in such notice. The sublessee shall have a right of reimbursement and offset from and against Lessee for any such Defaults cured by the sublessee.

### 13. **Default; Breach; Remedies.**

13.1 **Default; Breach.** A "Default" is defined as a failure by the Lessee to comply with or perform any of the terms, covenants, conditions or Rules and Regulations under this Lease. A "Breach" is defined as the occurrence of one or more of the following Defaults, and the failure of Lessee to cure such Default within any applicable grace period:

(a) The abandonment of the Premises; or the vacating of the Premises without providing a commercially reasonable level of security, or where the coverage of the property insurance described in Paragraph 8.3 is jeopardized as a result thereof, or without providing reasonable assurances to minimize potential vandalism.

(b) The failure of Lessee to make any payment of Rent or any Security Deposit required to be made by Lessee hereunder, whether to Lessor or to a third party, when due, to provide reasonable evidence of insurance or surety bond, or to fulfill any obligation under this Lease which endangers or threatens life or property, where such failure continues for a period of 3 business days following written notice to Lessee. THE ACCEPTANCE BY LESSOR OF A PARTIAL PAYMENT OF RENT OR SECURITY DEPOSIT SHALL NOT CONSTITUTE A WAIVER OF ANY OF LESSOR'S RIGHTS, INCLUDING LESSOR'S RIGHT TO RECOVER POSSESSION OF THE PREMISES.

(c) The failure of Lessee to allow Lessor and/or its agents access to the Premises or the commission of waste, act or acts constituting public or private nuisance, and/or an illegal activity on the Premises by Lessee, where such actions continue for a period of 3 business days following written notice to Lessee.

(d) The failure by Lessee to provide (i) reasonable written evidence of compliance with Applicable Requirements, (ii) the service contracts, (iii) the rescission of an unauthorized assignment or subletting, (iv) an Estoppel Certificate or financial statements, (v) a requested subordination, (vi) evidence concerning any guaranty and/or Guarantor, (vii) any document requested under Paragraph 41, (viii) material data safety sheets (MSDS), or (ix) any other documentation or information which Lessor may reasonably require of Lessee under the terms of this Lease, where any such failure continues for a period of 10 days following written notice to Lessee.

(e) A Default by Lessee as to the terms, covenants, conditions or provisions of this Lease, or of the rules adopted under Paragraph 2.9 hereof, other than those described in subparagraphs 13.1(a), (b), (c) or (d), above, where such Default continues for a period of 30 days after written notice; provided, however, that if the nature of Lessee's Default is such that more than 30 days are reasonably required for its cure, then it shall not be deemed to be a Breach if Lessee commences such cure within said 30 day period and thereafter diligently prosecutes such cure to completion.

(f) The occurrence of any of the following events: (i) the making of any general arrangement or assignment for the benefit of creditors; (ii) becoming a "debtor" as defined in 11 U.S.C. § 101 or any successor statute thereto (unless, in the case of a petition filed against Lessee, the same is dismissed within 60 days); (iii) the appointment of a trustee or receiver to take possession of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where possession is not restored to Lessee within 30 days; or (iv) the attachment, execution or other judicial seizure of substantially all of Lessee's assets located at the Premises or of Lessee's interest in this Lease, where such seizure is not discharged within 30 days; provided, however, in the event that any provision of this subparagraph is contrary to any applicable law, such provision shall be of no force or effect, and not affect the validity of the remaining provisions.

(g) The discovery that any financial statement of Lessee or of any Guarantor given to Lessor was materially false.

(h) If the performance of Lessee's obligations under this Lease is guaranteed: (i) the death of a Guarantor, (ii) the termination of a Guarantor's liability with respect to this Lease other than in accordance with the terms of such guaranty, (iii) a Guarantor's becoming insolvent or the subject of a bankruptcy filing, (iv) a Guarantor's refusal to honor the guaranty, or (v) a Guarantor's breach of its guaranty obligation on an anticipatory basis, and Lessee's failure, within 60 days following written notice of any such event, to provide written alternative assurance or security, which, when coupled with the then existing resources of Lessee, equals or exceeds the combined financial resources of Lessee and the Guarantors that existed at the time of execution of this Lease.

13.2 **Remedies.** If Lessee fails to perform any of its affirmative duties or obligations, within 10 days after written notice (or in case of an emergency, without notice), Lessor may, at its option, perform such duty or obligation on Lessee's behalf, including but not limited to the obtaining of reasonably required bonds, insurance policies, or governmental licenses, permits or approvals Lessee shall pay to Lessor an amount equal to 115% of the costs and expenses incurred by Lessor in such performance upon receipt of an invoice therefor. In the event of a Breach, Lessor may, with or without further notice or demand, and without limiting Lessor in the exercise of any right or remedy which Lessor may have by reason of such Breach:

(a) Terminate Lessee's right to possession of the Premises by any lawful means, in which case this Lease shall terminate and Lessee shall immediately surrender possession to Lessor. In such event Lessor shall be entitled to recover from Lessee: (i) the unpaid Rent which had been earned at the time of termination; (ii) the worth at the time of award of the amount by which the unpaid rent which would have been earned after termination until the time of award exceeds the amount of such rental loss that the Lessee proves could have been reasonably avoided; (iii) 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 the Lessee proves could be reasonably avoided; and (iv) any other amount necessary to

compensate Lessor for all the detriment proximately caused by the Lessee's failure to perform its obligations under this Lease or which in the ordinary course of things would be likely to result therefrom, including but not limited to the cost of recovering possession of the Premises, expenses of reletting, including necessary renovation and alteration of the Premises, reasonable attorneys' fees, and that portion of any leasing commission paid by Lessor in connection with this Lease applicable to the unexpired term of this Lease. The worth at the time of award of the amount referred to in provision (iii) of the immediately preceding sentence shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of the District within which the Premises are located at the time of award plus one percent. Efforts by Lessor to mitigate damages caused by Lessee's Breach of this Lease shall not waive Lessor's right to recover damages under Paragraph 12. If termination of this Lease is obtained through the provisional remedy of unlawful detainer, Lessor shall have the right to recover in such proceeding any unpaid Rent and damages as are recoverable therein, or Lessor may reserve the right to recover all or any part thereof in a separate suit. If a notice and grace period required under Paragraph 13.1 was not previously given, a notice to pay rent or quit, or to perform or quit given to Lessee under the unlawful detainer statute shall also constitute the notice required by Paragraph 13.1. In such case, the applicable grace period required by Paragraph 13.1 and the unlawful detainer statute shall run concurrently, and the failure of Lessee to cure the Default within the greater of the two such grace periods shall constitute both an unlawful detainer and a Breach of this Lease entitling Lessor to the remedies provided for in this Lease and/or by said statute.



(b) Continue the Lease and Lessee's right to possession and recover the Rent as it becomes due, in which event Lessee may sublet or assign, subject only to reasonable limitations. Acts of maintenance, efforts to relet, and/or the appointment of a receiver to protect the Lessor's interests, shall not constitute a termination of the Lessee's right to possession.

(c) Pursue any other remedy now or hereafter available under the laws or judicial decisions of the state wherein the Premises are located. The expiration or termination of this Lease and/or the termination of Lessee's right to possession shall not relieve Lessee from liability under any indemnity provisions of this Lease as to matters occurring or accruing during the term hereof or by reason of Lessee's occupancy of the Premises.

**13.3 Inducement Recapture.** Any agreement for free or abated rent or other charges, or for the giving or paying by Lessor to or for Lessee of any cash or other bonus, inducement or consideration for Lessee's entering into this Lease, all of which concessions are hereinafter referred to as "**Inducement Provisions**", shall be deemed conditioned upon Lessee's full and faithful performance of all of the terms, covenants and conditions of this Lease. Upon Breach of this Lease by Lessee, any such Inducement Provision shall automatically be deemed deleted from this Lease and of no further force or effect, and any rent, other charge, bonus, inducement or consideration theretofore abated, given or paid by Lessor under such an Inducement Provision shall be immediately due and payable by Lessee to Lessor, notwithstanding any subsequent cure of said Breach by Lessee. The acceptance by Lessor of rent or the cure of the Breach which initiated the operation of this paragraph shall not be deemed a waiver by Lessor of the provisions of this paragraph unless specifically so stated in writing by Lessor at the time of such acceptance.

**13.4 Late Charges.** Lessee hereby acknowledges that late payment by Lessee of Rent will cause Lessor to incur costs not contemplated by this Lease, the exact amount of which will be extremely difficult to ascertain. Such costs include, but are not limited to, processing and accounting charges, and late charges which may be imposed upon Lessor by any Lender. Accordingly, if any Rent shall not be received by Lessor within 5 days after such amount shall be due, then, without any requirement for notice to Lessee, Lessee shall immediately pay to Lessor a one-time late charge equal to 10% of each such overdue amount or \$100, whichever is greater. The parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Lessor will incur by reason of such late payment. Acceptance of such late charge by Lessor shall in no event constitute a waiver of Lessee's Default or Breach with respect to such overdue amount, nor prevent the exercise of any of the other rights and remedies granted hereunder. In the event that a late charge is payable hereunder, whether or not collected, for 3 consecutive installments of Base Rent, then notwithstanding any provision of this Lease to the contrary, Base Rent shall, at Lessor's option, become due and payable quarterly in advance.

**13.5 Interest.** Any monetary payment due Lessor hereunder, other than late charges, not received by Lessor, when due as to scheduled payments (such as Base Rent) or within 30 days following the date on which it was due for non-scheduled payment, shall bear interest from the date when due, as to scheduled payments, or the 31st day after it was due as to non-scheduled payments. The interest ("**Interest**") charged shall be computed at the rate of 10% per annum but shall not exceed the maximum rate allowed by law. Interest is payable in addition to the potential late charge provided for in Paragraph 13.4.

#### **13.6 Breach by Lessor.**

(a) **Notice of Breach.** Lessor shall not be deemed in breach of this Lease unless Lessor fails within a reasonable time to perform an obligation required to be performed by Lessor. For purposes of this Paragraph, a reasonable time shall in no event be less than 30 days after receipt by Lessor, and any Lender whose name and address shall have been furnished to Lessee in writing for such purpose, of written notice specifying wherein such obligation of Lessor has not been performed; provided, however, that if the nature of Lessor's obligation is such that more than 30 days are reasonably required for its performance, then Lessor shall not be in breach if performance is commenced within such 30 day period and thereafter diligently pursued to completion.

(b) **Performance by Lessee on Behalf of Lessor.** In the event that neither Lessor nor Lender cures said breach within 30 days after receipt of said notice, or if having commenced said cure they do not diligently pursue it to completion, then Lessee may elect to cure said breach at Lessee's expense and offset from Rent the actual and reasonable cost to perform such cure, provided however, that such offset shall not exceed an amount equal to the greater of one month's Base Rent or the Security Deposit, reserving Lessee's right to reimbursement from Lessor for any such expense in excess of such offset. Lessee shall document the cost of said cure and supply said documentation to Lessor.

**14. Condemnation.** If the Premises or any portion thereof are taken under the power of eminent domain or sold under the threat of the exercise of said power (collectively "**Condemnation**"), this Lease shall terminate as to the part taken as of the date the condemning authority takes title or possession, whichever first occurs. If more than 10% of the floor area of the Unit, or more than 25% of the parking spaces is taken by Condemnation, Lessee may, at Lessee's option, to be exercised in writing within 10 days after Lessor shall have given Lessee written notice of such taking (or in the absence of such notice, within 10 days after the condemning authority shall have taken possession) terminate this Lease as of the date the condemning authority takes such possession. If Lessee does not terminate this Lease in accordance with the foregoing, this Lease shall remain in full force and effect as to the portion of the Premises remaining, except that the Base Rent shall be reduced in proportion of the reduction in utility of the Premises caused by such Condemnation. Condemnation awards and/or payments shall be the property of Lessor, whether such award shall be made as compensation for diminution in value of the leasehold, the value of the part taken, or for severance damages; provided, however, that Lessee shall be entitled to any compensation paid by the condemnor for Lessee's relocation expenses, loss of business goodwill and/or Trade Fixtures, without regard to whether or not this Lease is terminated pursuant to the provisions of this Paragraph. All Alterations and Utility Installations made to the Premises by Lessee, for purposes of Condemnation only, shall be considered the property of the Lessee and Lessee shall be entitled to any and all compensation which is payable therefor. In the event that this Lease is not terminated by reason of the Condemnation, Lessor shall repair any damage to the Premises caused by such Condemnation.

#### **15. Brokerage Fees.**

**15.1 Additional Commission.** In addition to the payments owed pursuant to Paragraph 1.10 above, and unless Lessor and the Brokers otherwise agree in writing, Lessor agrees that: (a) if Lessee exercises any Option, (b) if Lessee or anyone affiliated with Lessee acquires from Lessor any rights to the Premises or other premises owned by Lessor and located within the Project, (c) if Lessee remains in possession of the Premises, with the consent of Lessor, after the expiration of this Lease, or (d) if Base Rent is increased, whether by agreement or operation of an escalation clause herein, then, Lessor shall pay Brokers a fee in accordance with the schedule of the Brokers in effect at the time of the execution of this Lease.

**15.2 Assumption of Obligations.** Any buyer or transferee of Lessor's interest in this Lease shall be deemed to have assumed Lessor's obligation hereunder. Brokers shall be third party beneficiaries of the provisions of Paragraphs 1.10, 15, 22 and 31. If Lessor fails to pay to Brokers any amounts due as and for brokerage fees pertaining to this Lease when due, then such amounts shall accrue interest. In addition, if Lessor fails to pay any amounts to Lessee's Broker when due, Lessee's Broker may send written notice to Lessor and Lessee of such failure and if Lessor fails to pay such amounts within 10 days after said notice, Lessee shall pay said monies to its Broker and offset

such amounts against Rent. In addition, Lessee's Broker shall be deemed to be a third party beneficiary of any commission agreement entered into by and/or between Lessor and Lessor's Broker for the limited purpose of collecting any brokerage fee owed.

15.3 **Representations and Indemnities of Broker Relationships.** Lessee and Lessor each represent and warrant to the other that it has had no dealings with any person, firm, broker or finder (other than the Brokers, if any) in connection with this Lease, and that no one other than said named Brokers is entitled to any commission or finder's fee in connection herewith. Lessee and Lessor do each hereby agree to indemnify, protect, defend and hold the other harmless from and against liability for compensation or charges which may be claimed by any such unnamed broker, finder or other similar party by reason of any dealings or actions of the indemnifying Party, including any costs, expenses, attorneys' fees reasonably incurred with respect thereto.

16. **Estoppel Certificates.**

(a) Each Party (as "**Responding Party**") shall within 10 days after written notice from the other Party (the "**Requesting Party**") execute, acknowledge and deliver to the Requesting Party a statement in writing in form similar to the then most current "**Estoppel Certificate**" form published by the AIR Commercial Real Estate Association, plus such additional information, confirmation and/or statements as may be reasonably requested by the Requesting Party.

(b) If the Responding Party shall fail to execute or deliver the Estoppel Certificate within such 10 day period, the Requesting Party may execute an Estoppel Certificate stating that: (i) the Lease is in full force and effect without modification except as may be represented by the Requesting Party, (ii) there are no uncured defaults in the Requesting Party's performance, and (iii) if Lessor is the Requesting Party, not more than one month's rent has been paid in advance. Prospective purchasers and encumbrancers may rely upon the Requesting Party's Estoppel Certificate, and the Responding Party shall be estopped from denying the truth of the facts contained in said Certificate.

(c) If Lessor desires to finance, refinance, or sell the Premises, or any part thereof, Lessee and all Guarantors shall within 10 days after written notice from Lessor deliver to any potential lender or purchaser designated by Lessor such financial statements as may be reasonably required by such lender or purchaser, including but not limited to Lessee's financial statements for the past 3 years. All such financial statements shall be received by Lessor and such lender or purchaser in confidence and shall be used only for the purposes herein set forth.

17. **Definition of Lessor.** The term "Lessor" as used herein shall mean the owner or owners at the time in question of the fee title to the Premises, or, if this is a sublease, of the Lessee's interest in the prior lease. In the event of a transfer of Lessor's title or interest in the Premises or this Lease, Lessor shall deliver to the transferee or assignee (in cash or by credit) any unused Security Deposit held by Lessor. Upon such transfer or assignment and delivery of the Security Deposit, as aforesaid, the prior Lessor shall be relieved of all liability with respect to the obligations and/or covenants under this Lease thereafter to be performed by the Lessor. Subject to the foregoing, the obligations and/or covenants in this Lease to be performed by the Lessor shall be binding only upon the Lessor as hereinabove defined.

18. **Severability.** The invalidity of any provision of this Lease, as determined by a court of competent jurisdiction, shall in no way affect the validity of any other provision hereof.

19. **Days.** Unless otherwise specifically indicated to the contrary, the word "days" as used in this Lease shall mean and refer to calendar days.

20. **Limitation on Liability.** The obligations of Lessor under this Lease shall not constitute personal obligations of Lessor, or its partners, members, directors, officers or shareholders, and Lessee shall look to the Premises, and to no other assets of Lessor, for the satisfaction of any liability of Lessor with respect to this Lease, and shall not seek recourse against Lessor's partners, members, directors, officers or shareholders, or any of their personal assets for such satisfaction.

21. **Time of Essence.** Time is of the essence with respect to the performance of all obligations to be performed or observed by the Parties under this Lease.

22. **No Prior or Other Agreements; Broker Disclaimer.** This Lease contains all agreements between the Parties with respect to any matter mentioned herein, and no other prior or contemporaneous agreement or understanding shall be effective. Lessor and Lessee each represents and warrants to the Brokers that it has made, and is relying solely upon, its own investigation as to the nature, quality, character and financial responsibility of the other Party to this Lease and as to the use, nature, quality and character of the Premises. Brokers have no responsibility with respect thereto or with respect to any default or breach hereof by either Party.

23. **Notices.**

23.1 **Notice Requirements.** All notices required or permitted by this Lease or applicable law shall be in writing and may be delivered in person (by hand or by courier) or may be sent by regular, certified or registered mail or US Postal Service Express Mail, with postage prepaid, or by facsimile transmission, and shall be deemed sufficiently given if served in a manner specified in this Paragraph 23. The addresses noted adjacent to a Party's signature on this Lease shall be that Party's address for delivery or mailing of notices. Either Party may by written notice to the other specify a different address for notice, except that upon Lessee's taking possession of the Premises, the Premises shall constitute Lessee's address for notice. A copy of all notices to Lessor shall be concurrently transmitted to such party or parties at such addresses as Lessor may from time to time hereafter designate in writing.

23.2 **Date of Notice.** Any notice sent by registered or certified mail, return receipt requested, shall be deemed given on the date of delivery shown on the receipt card, or if no delivery date is shown, the postmark thereon. If sent by regular mail the notice shall be deemed given 72 hours after the same is addressed as required herein and mailed with postage prepaid. Notices delivered by United States Express Mail or overnight courier that guarantees next day delivery shall be deemed given 24 hours after delivery of the same to the Postal Service or courier. Notices transmitted by facsimile transmission or similar means shall be deemed delivered upon telephone confirmation of receipt (confirmation report from fax machine is sufficient), provided a copy is also delivered via delivery or mail. If notice is received on a Saturday, Sunday or legal holiday, it shall be deemed received on the next business day.

24. **Waivers.**

(a) No waiver by Lessor of the Default or Breach of any term, covenant or condition hereof by Lessee, shall be deemed a waiver of any other term, covenant or condition hereof, or of any subsequent Default or Breach by Lessee of the same or of any other term, covenant or condition hereof. Lessor's consent to, or approval of, any act shall not be deemed to render unnecessary the obtaining of Lessor's consent to, or approval of, any subsequent or similar act by Lessee, or be construed as the basis of an estoppel to enforce the provision or provisions of this Lease requiring such consent.

(b) The acceptance of Rent by Lessor shall not be a waiver of any Default or Breach by Lessee. Any payment by Lessee may be accepted by Lessor on account of monies or damages due Lessor, notwithstanding any qualifying statements or conditions made by Lessee in connection therewith, which such statements and/or conditions shall be of no force or effect whatsoever unless specifically agreed to in writing by Lessor at or before the time of deposit of such payment.

(c) THE PARTIES AGREE THAT THE TERMS OF THIS LEASE SHALL GOVERN WITH REGARD TO ALL MATTERS RELATED THERETO AND HEREBY WAIVE THE PROVISIONS OF ANY PRESENT OR FUTURE STATUTE TO THE EXTENT THAT SUCH STATUTE IS INCONSISTENT WITH THIS LEASE.

25. **Disclosures Regarding The Nature of a Real Estate Agency Relationship.**

(a) When entering into a discussion with a real estate agent regarding a real estate transaction, a Lessor or Lessee should from the outset understand what type of agency relationship or representation it has with the agent or agents in the transaction. Lessor and Lessee acknowledge being advised by the Brokers in this transaction, as follows:

(i) **Lessor's Agent.** A Lessor's agent under a listing agreement with the Lessor acts as the agent for the Lessor only. A Lessor's agent or subagent has the following affirmative obligations: *To the Lessor:* A fiduciary duty of utmost care, integrity, honesty, and loyalty in dealings with the Lessor. *To the Lessee and the Lessor:* a. Diligent exercise of reasonable skills and care in performance of the agent's duties. b. A duty of honest and fair dealing and good faith. c. A duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the Parties. An agent is not obligated to reveal to either Party any confidential information obtained from the other Party which does not involve the affirmative duties set forth above.

(ii) **Lessee's Agent.** An agent can agree to act as agent for the Lessee only. In these situations, the agent is not the Lessor's agent, even if by agreement the agent may receive compensation for services rendered, either in full or in part from the Lessor. An agent acting only for a Lessee has the following affirmative obligations. *To the Lessee:* A fiduciary duty of utmost care, integrity, honesty, and loyalty in dealings with the Lessee. *To the Lessee and the Lessor:* a. Diligent exercise of reasonable skills and care in performance of the agent's duties. b. A duty of honest and fair dealing and good faith. c. A duty to disclose all facts known to the agent materially affecting the value or desirability of the property that are not known to, or within the diligent attention and observation of, the Parties. An agent is not obligated to reveal to either Party any confidential information obtained from the other Party which does not involve the affirmative duties set forth above.

(iii) **Agent Representing Both Lessor and Lessee.** A real estate agent, either acting directly or through one or more associate licenses, can legally be the agent of both the Lessor and the Lessee in a transaction, but only with the knowledge and consent of both the Lessor and the Lessee. In a dual agency situation, the agent has the following affirmative obligations to both the Lessor and the Lessee: a. A fiduciary duty of utmost care, integrity, honesty and loyalty in the dealings with either Lessor or the Lessee b. Other duties to the Lessor and the Lessee as stated above in subparagraphs (i) or (ii) in representing both Lessor and Lessee, the agent may not without the express permission of the respective Party, disclose to the other Party that the Lessor will accept rent in an amount less than that indicated in the listing or that the Lessee is willing to pay a higher rent than that offered, The above duties of the agent in a real estate transaction do not relieve a Lessor or Lessee from the responsibility to protect their own interests. Lessor and Lessee should carefully read all agreements to assure that they adequately express their understanding of the transaction. A real estate agent is a person qualified to advise about real estate. If legal or tax advice is desired, consult a competent professional.

(b) Brokers have no responsibility with respect to any default or breach hereof by either Party The Parties agree that no lawsuit or other legal proceeding involving any breach of duty, error or omission relating to this Lease may be brought against Broker more than one year after the Start Date and that the liability (including court costs and attorneys' fees), of any Broker with respect to any such lawsuit and/or legal proceeding shall not exceed the fee received by such Broker pursuant to this Lease; provided, however, that the foregoing limitation on each Brokers liability shall not be applicable to any gross negligence or willful misconduct of such Broker.

(c) Lessor and Lessee agree to identify to Brokers as "Confidential" any communication or information given Brokers that is considered by such Party to be confidential.

26. **No Right To Holdover.** Lessee has no right to retain possession of the Premises or any part thereof beyond the expiration or termination of this Lease. In the event that Lessee holds over, then the Base Rent shall be increased to 150% of the Base Rent applicable immediately preceding the expiration or termination. Nothing contained herein shall be construed as consent by Lessor to any holding over by Lessee.

27. **Cumulative Remedies.** No remedy or election hereunder shall be deemed exclusive but shall, wherever possible, be cumulative with all other remedies at law or in equity.

28. **Covenants and Conditions; Construction of Agreement.** All provisions of this Lease to be observed or performed by Lessee are both covenants and conditions. In construing this Lease, all headings and titles are for the convenience of the Parties only and shall not be considered a part of this Lease. Whenever required by the context, the singular shall include the plural and vice versa. This Lease shall not be construed as if prepared by one of the Parties, but rather according to its fair meaning as a whole, as if both Parties had prepared it.

29. **Binding Effect; Choice of Law.** This Lease shall be binding upon the parties, their personal representatives, successors and assigns and be governed by the laws of the State in which the Premises are located. Any litigation between the Parties hereto concerning this Lease shall be initiated in the county in which the Premises are located.

30. **Subordination; Attornment; on-Disturbance.**

30.1 **Subordination.** This Lease and any Option granted hereby shall be subject and subordinate to any ground lease, mortgage, deed of trust, or other hypothecation or security device (collectively, "**Security Device**"), now or hereafter placed upon the Premises, to any and all advances made on the security thereof, and to all renewals, modifications, and extensions thereof. Lessee agrees that the holders of any such Security Devices (in this Lease together referred to as "**Lender**") shall have no liability or obligation to perform any of the obligations of Lessor under this Lease. Any Lender may elect to have this Lease and/or any Option granted hereby superior to the lien of its Security Device by giving written notice thereof to Lessee, whereupon this Lease and such Options shall be deemed prior to such Security Device, notwithstanding the relative dates of the documentation or recordation thereof.

30.2 **Attornment.** In the event that Lessor transfers title to the Premises, or the Premises are acquired by another upon the foreclosure or termination of a Security Device to which this Lease is subordinated (i) Lessee shall, subject to the non-disturbance provisions of Paragraph 30.3, attorn to such new owner, and upon request, enter into a new lease, containing all of the terms and provisions of this Lease, with such new owner for the remainder of the term hereof, or, at the election of the new owner, this Lease will automatically become a new lease between Lessee and such new owner, and (ii) Lessor shall thereafter be relieved of any further obligations hereunder and such new owner shall assume all of Lessor's obligations, except that such new owner shall not: (a) be liable for any act or omission of any prior lessor or with respect to events occurring prior to acquisition of ownership; (b) be subject to any offsets or defenses which Lessee might have against any prior lessor, (c) be bound by prepayment of more than one month's rent, or (d) be liable for the return of any security deposit paid to any prior lessor which was not paid or credited to such new owner.

30.3 **Non-Disturbance.** With respect to Security Devices entered into by Lessor after the execution of this Lease, Lessee's subordination of this Lease shall be subject to receiving a commercially reasonable non-disturbance agreement (a "**Non-Disturbance Agreement**") from the Lender which Non-Disturbance Agreement provides that Lessee's possession of the Premises, and this Lease, including any options to extend the term hereof, will not be disturbed so long as Lessee is not in Breach hereof and attorns to the record owner of the Premises. Further, within 60 days after the execution of this Lease, Lessor shall, if requested by Lessee, use its commercially reasonable efforts to obtain a Non-Disturbance Agreement from the holder of any pre-existing Security Device which is secured by the Premises. In the event that Lessor is unable to provide the Non-Disturbance Agreement within said 60 days, then Lessee may, at Lessee's

option, directly contact Lender and attempt to negotiate for the execution and delivery of a Non-Disturbance Agreement

30.4 **Self-Executing.** The agreements contained in this Paragraph 30 shall be effective without the execution of any further documents provided, however, that, upon written request from Lessor or a Lender in connection with a sale, financing or refinancing of the Premises, Lessee and Lessor shall execute such further writings as may be reasonably required to separately document any subordination, attornment and/or Non-Disturbance Agreement provided for herein.

31. **Attorneys' Fees.** if any Party or Broker brings an action or proceeding involving the Premises whether founded in tort, contract or equity, or to declare rights hereunder, the Prevailing Party (as hereafter defined) in any such proceeding, action, or appeal thereon, shall be entitled to reasonable attorneys' fees. Such fees may be awarded in the same suit or recovered in a separate suit, whether or not such action or proceeding is pursued to decision or judgment. The term, "**Prevailing Party**" shall include, without limitation, a Party or Broker who substantially obtains or defeats the relief sought, as the case may be, whether by compromise, settlement, judgment, or the abandonment by the other Party or Broker of its claim or defense. The attorneys' fees award shall not be computed in accordance with any court fee schedule, but shall be such as to fully reimburse all attorneys' fees reasonably incurred. In addition, Lessor shall be entitled to attorneys' fees, costs and expenses incurred in the preparation and service of notices of Default and consultations in connection therewith, whether or not a legal action is subsequently commenced in connection with such Default or resulting Breach (\$200 is a reasonable minimum per occurrence for such services and consultation).

32. **Lessor's Access; Showing Premises; Repairs.** Showing Premises; Repairs Lessor and Lessor's agents shall have the right to enter the Premises at any time, in the case of an emergency, and otherwise at reasonable times after reasonable prior notice for the purpose of showing the same to prospective purchasers, lenders, or tenants, and making such alterations, repairs, improvements or additions to the Premises as Lessor may deem necessary or desirable and the erecting, using and maintaining of utilities, services, pipes and conduits through the Premises and/or other premises as long as there is no material adverse effect on Lessee's use of the Premises. ALL such activities shall be without abatement of rent or liability to Lessee.

33. **Auctions.** Lessee shall not conduct, nor permit to be conducted, any auction upon the Premises without Lessor's prior written consent. Lessor shall not be obligated to exercise any standard of reasonableness in determining whether to permit an auction.

34. **Signs.** Lessor may place on the Premises ordinary "For Sale" signs at any time and ordinary "For Lease" signs during the last 6 months of the term hereof, Except for ordinary "For Sublease" signs which may be placed only on the Premises, Lessee shall not place any sign upon the Project without Lessor's prior written consent. All signs must comply with all Applicable Requirements.

35. **Termination; Merger.** Unless specifically stated otherwise in writing by Lessor, the voluntary or other surrender of this Lease by Lessee, the mutual termination or cancellation hereof, or a termination hereof by Lessor for Breach by Lessee, shall automatically terminate any sublease or lesser estate in the Premises; provided, however, that Lessor may elect to continue any one or all existing subtenancies. Lessor's failure within 10 days following any such event to elect to the contrary by written notice to the holder of any such lesser interest, shall constitute Lessor's election to have such event constitute the termination of such interest.

36. **Consents.** Except as otherwise provided herein, wherever in this Lease the consent of a Party is required to an act by or for the other Party, such consent shall not be unreasonably withheld or delayed. Lessor's actual reasonable costs and expenses (including but not limited to architects', attorneys', engineers' and other consultants' fees) incurred in the consideration of, or response to, a request by Lessee for any Lessor consent, including but not limited to consents to an assignment, a subletting or the presence or use of a Hazardous Substance, shall be paid by Lessee upon receipt of an invoice and supporting documentation therefor. Lessor's consent to any act, assignment or subletting shall not constitute an acknowledgment that no Default or Breach by Lessee of this Lease exists, nor shall such consent be deemed a waiver of any then-existing Default or Breach, except as may be otherwise specifically stated in writing by Lessor at the time of such consent. The failure to specify herein any particular condition to Lessor's consent shall not preclude the imposition by Lessor at the time of consent of such further or other conditions as are then reasonable with reference to the particular matter for which consent is being given. In the event that either Party disagrees with any determination made by the other hereunder and reasonably requests the reasons for such determination, the determining party shall furnish its reasons in writing and in reasonable detail within 10 business days following such request.

37. **Guarantor.**

37.1 **Execution.** The Guarantors, if any, shall each execute a guaranty in the form most recently published by the AIR Commercial Real Estate Association.

37.2 **Default.** It shall constitute a Default of the Lessee if any Guarantor fails or refuses, upon request to provide: (a) evidence of the execution of the guaranty, including the authority of the party signing on Guarantor's behalf to obligate Guarantor, and in the case of a corporate Guarantor, a certified copy of a resolution of its board of directors authorizing the making of such guaranty, (b) current financial statements, (c) an Estoppel Certificate, or (d) written confirmation that the guaranty is still in effect.

38. **Quiet Possession** Subject to payment by Lessee of the Rent and performance of all of the covenants, conditions and provisions on Lessee's part to be observed and performed under this Lease, Lessee shall have quiet possession and quiet enjoyment of the Premises during the term hereof.

39. **Options.** If Lessee is granted an option, as defined below, then the following provisions shall apply.

39.1 **Definition. "Option"** shall mean: (a) the right to extend or reduce the term of or renew this Lease or to extend or reduce the term of or renew any lease that Lessee has on other property of Lessor; (b) the right of first refusal or first offer to lease either the Premises or other property of Lessor; (c) the right to purchase, the right of first offer to purchase or the right of first refusal to purchase the Premises or other property of Lessor.

39.2 **Options Personal To Original Lessee.** Any Option granted to Lessee in this Lease is personal to the original Lessee, and cannot be assigned or exercised by anyone other than said original Lessee and only while the original Lessee is in full possession of the Premises and, if requested by Lessor, with Lessee certifying that Lessee has no intention of thereafter assigning or subletting.

39.3 **Multiple Options.** In the event that Lessee has any multiple Options to extend or renew this Lease, a later Option cannot be exercised unless the prior Options have been validly exercised.

39.4 **Effect of Default on Options.**

(a) Lessee shall have no right to exercise an Option: (i) during the period commencing with the giving of any notice of Default and continuing until said Default is cured, (ii) during the period of time any Rent is unpaid (without regard to whether notice thereof is given Lessee), (iii) during the time Lessee is in Breach of this Lease, or (iv) in the event that Lessee has been given 3 or more notices of separate Default, whether or not the Defaults are cured, during the 12 month period immediately preceding the exercise of the Option.

(b) The period of time within which an Option may be exercised shall not be extended or enlarged by reason of Lessee's inability to exercise an Option because of the provisions of Paragraph 39.4(a).

(c) An Option shall terminate and be of no further force or effect, notwithstanding Lessee's due and timely exercise of the Option, if, after such exercise and prior to the commencement of the extended term or completion of the purchase, (i) Lessee fails to pay Rent for a period of 30 days after such Rent becomes due (without any necessity of Lessor to give notice thereof), or (ii) if Lessee commits a Breach of this Lease.

40. **Security Measures.** Lessee hereby acknowledges that the Rent payable to Lessor hereunder does not include the cost of guard service or other security measures, and that Lessor shall have no obligation whatsoever to provide same. Lessee assumes all responsibility for the protection of the Premises, Lessee, its agents and invitees and their property from the acts of third parties.

41. **Reservations.** Lessor reserves the right: (i) to grant, without the consent or joinder of Lessee, such easements, rights and dedications that Lessor deems necessary, (ii) to cause the recordation of parcel maps and restrictions, and (iii) to create and/or install new utility raceways, so long as such easements, rights, dedications, maps, restrictions, and utility raceways do not unreasonably interfere with the use of the Premises by Lessee. Lessee agrees to sign any documents reasonably requested by Lessor to effectuate such rights.

42. **Performance Under Protest.** If at any time a dispute shall arise as to any amount or sum of money to be paid by one Party to the other under the provisions hereof, the Party against whom the obligation to pay the money is asserted shall have the right to make payment "under protest" and such payment shall not be regarded as a voluntary payment and there shall survive the right on the part of said Party to institute suit for recovery of such sum. If it shall be adjudged that there was no legal obligation on the part of said Party to pay such sum or any part thereof, said Party shall be entitled to recover such sum or so much thereof as it was not legally required to pay. A Party who does

not initiate suit for the recovery of sums paid "under protest" within 6 months shall be deemed to have waived its right to protest such payment.



43. **Authority; Multiple Parties; Execution.**

(a) If either Party hereto is a corporation, trust, limited liability company, partnership, or similar entity, each individual executing this Lease on behalf of such entity represents and warrants that he or she is duly authorized to execute and deliver this Lease on its behalf. Each Party shall, within 30 days after request, deliver to the other Party satisfactory evidence of such authority.

(b) If this Lease is executed by more than one person or entity as "Lessee", each such person or entity shall be jointly and severally liable hereunder. It is agreed that any one of the named Lessees shall be empowered to execute any amendment to this Lease, or other document ancillary thereto and bind all of the named Lessees, and Lessor may rely on the same as if all of the named Lessees had executed such document.

(c) This Lease may be executed by the Parties in counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same instrument.

44. **Conflict.** Any conflict between the printed provisions of this Lease and the typewritten or handwritten provisions shall be controlled by the typewritten or handwritten provisions.

45. **Offer.** Preparation of this Lease by either party or their agent and submission of same to the other Party shall not be deemed an offer to lease to the other Party. This Lease is not intended to be binding until executed and delivered by all Parties hereto.

46. **Amendments.** This Lease may be modified only in writing, signed by the Parties in interest at the time of the modification. As long as they do not materially change Lessee's obligations hereunder, Lessee agrees to make such reasonable non-monetary modifications to this Lease as may be reasonably required by a Lender in connection with the obtaining of normal financing or refinancing of the Premises.

47. **Waiver of Jury Trial. THE PARTIES HEREBY WAIVE THEIR RESPECTIVE RIGHTS TO TRIAL BY JURY IN ANY ACTION OR PROCEEDING INVOLVING THE PROPERTY OR ARISING OUT OF THIS AGREEMENT.**

48. **Arbitration of Disputes.** An Addendum requiring the Arbitration of all disputes between the Parties and/or Brokers arising out of this Lease is not attached to this Lease.

49. **Americans with Disabilities Act.** Since compliance with the Americans with Disabilities Act (ADA) is dependent upon Lessee's specific use of the Premises, Lessor makes no warranty or representation as to whether or not the Premises comply with ADA or any similar legislation. In the event that Lessee's use of the Premises requires modifications or additions to the Premises in order to be in ADA compliance, Lessee agrees to make any such necessary modifications and/or additions at Lessee's expense.

**LESSOR AND LESSEE HAVE CAREFULLY READ AND REVIEWED THIS LEASE AND EACH TERM AND PROVISION CONTAINED HEREIN, AND BY THE EXECUTION OF THIS LEASE SHOW THEIR INFORMED AND VOLUNTARY CONSENT THERETO. THE PARTIES HEREBY AGREE THAT, AT THE TIME THIS LEASE IS EXECUTED, THE TERMS OF THIS LEASE ARE COMMERCIALY REASONABLE AND EFFECTUATE THE INTENT AND PURPOSE OF LESSOR AND LESSEE WITH RESPECT TO THE PREMISES.**

**ATTENTION: NO REPRESENTATION OR RECOMMENDATION IS MADE BY THE AIR COMMERCIAL REAL ESTATE ASSOCIATION OR BY ANY BROKER AS TO THE LEGAL SUFFICIENCY, LEGAL EFFECT, OR TAX CONSEQUENCES OF THIS LEASE OR THE TRANSACTION TO WHICH IT RELATES. THE PARTIES ARE URGED TO:**

1. **SEEK ADVICE OF COUNSEL AS TO THE LEGAL AND TAX CONSEQUENCES OF THIS LEASE.**

2. **RETAIN APPROPRIATE CONSULTANTS TO REVIEW AND INVESTIGATE THE CONDITION OF THE PREMISES. SAID INVESTIGATION SHOULD INCLUDE BUT NOT BE LIMITED TO: THE POSSIBLE PRESENCE OF HAZARDOUS SUBSTANCES, THE ZONING OF THE PREMISES, THE STRUCTURAL INTEGRITY, THE CONDITION OF THE ROOF AND OPERATING SYSTEMS, COMPLIANCE WITH THE AMERICANS WITH DISABILITIES ACT AND THE SUITABILITY OF THE PREMISES FOR LESSEE'S INTENDED USE.**

**WARNING: IF THE PREMISES ARE LOCATED IN A STATE OTHER THAN CALIFORNIA, CERTAIN PROVISIONS OF THE LEASE MAY NEED TO BE REVISED TO COMPLY WITH THE LAWS OF THE STATE IN WHICH THE PREMISES ARE LOCATED.**

The parties hereto have executed this Lease at the place and on the dates specified above their respective signatures

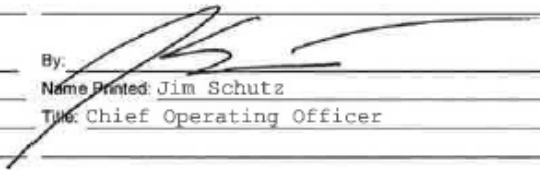
Executed at: \_\_\_\_\_ Executed: \_\_\_\_\_  
On: \_\_\_\_\_ On: \_\_\_\_\_

**By LESSOR:**

KCMKC Properties

**By LESSEE:**

Oculus Inc. A Delaware Corporation

By: \_\_\_\_\_ By:   
Name Printed: \_\_\_\_\_ Name Printed: Jim Schutz  
Title: \_\_\_\_\_ Title: Chief Operating Officer

By: \_\_\_\_\_ By: \_\_\_\_\_  
Name Printed: \_\_\_\_\_ Name Printed: \_\_\_\_\_  
Title: \_\_\_\_\_ Title: \_\_\_\_\_

Address: \_\_\_\_\_ Address: 1129 North McDowell Blvd.  
Petaluma, CA 94954

Telephone: (\_\_\_\_) \_\_\_\_\_ Telephone: (707) 283-0550  
Facsimile: (\_\_\_\_) \_\_\_\_\_ Facsimile: (\_\_\_\_) \_\_\_\_\_  
Federal ID No. \_\_\_\_\_ Federal ID No. \_\_\_\_\_

**BROKER:**

Cornish & Carey Commercial  
 Newmark Knight Frank

Alt: Mike Smith

Title:

Address: 1601 Response Road, Suite 160  
 Sacramento, CA 95815

Telephone: (916) 920-4400

Facsimile: (916) 920-0854

Federal ID No.

Lic #: 01504428

**BROKER:**

Cornish & Carey Commercial  
 Newmark Knight Frank

Alt: David Brandenburger

Title:

Address: 1601 Reponse Road, Suite 160  
 Sacramento, CA 95815

Telephone: (916) 920-4400

Facsimile: (916) 920-0854

Federal ID No.

Lic #: 01408572

**NOTICE:** These forms are often modified to meet changing requirements of law and industry needs. Always write or call to make sure you are utilizing the most current form: AIR Commercial Real Estate Association, 800 W 6th Street, Suite 800, Los Angeles, CA 90017. Telephone No. (213) 687-8777. Fax No.: (213) 687-8816.

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Addendum

**ADDENDUM TO STANDARD INDUSTRIAL/COMMERCIAL MULTI-TENANT LEASE-  
GROSS  
BY AND BETWEEN  
KCMKC PROPERTIES, LLP, AS LESSOR, AND  
OCULUS INC. A DELAWARE CORPORATION, AS LESSEE  
FOR THE PROPERTY LOCATED AT 3045 65TH STREET, #13  
DATED OCTOBER 31, 2011**

50. **Rent Schedule:**

<u>Months</u>	<u>Base Rent</u>
00-01	Free
02-13	\$810.00

Please note that KCMKC Properties, LLP must receive the rent checks on or before the end of the business day on the 9th of each month. If rent checks are late 2 times anytime during this lease, KCMKC Properties, LLP reserve the right to increase the total monthly amount 10% to satisfy the inconvenience and that increased monthly rental amount becomes the new rental amount for the balance of the lease period.

If during the period of lease, there are any unforeseen or unexpected increases in the maintenance of the complex, or Lessee's particular unit, KCMKC Properties, LLP reserve the right to additionally assess a fair share to Lessee.

51. **Occupancy Type:**

Should any governmental authority require any additional improvements, modifications, licenses, and/or permits of any kind, including, but not limited to, a conditional use permit due to Lessee's use and/or occupancy of the Premises, it shall be provided by Lessee, at Lessee's sole expense. It is Lessor's understanding that Lessee will not be using flammable solvents or utilizing the Premises in any way that would cause Lessee's occupancy to be considered anything other than a B-1 or B-2 type occupant.

In the event that Lessee is classified under any other occupancy type (such as 11-2 or 11-3 type for example) which requires any additional improvements to the space (i.e., additional fire sprinkler drops, ventilation equipment, and/or ducting, additional sheetrock, etc.) or by Lessee's use of the Premises, increases the fire insurance premiums on the building, Lessee shall be responsible to pay for and/or provide the same.

52. **Toxics Disclosure:**

"Landlord and Tenant acknowledge that they have been advised that numerous federal, state, and/or local laws, ordinances and regulations ("Laws") affect the existence and removal, storage, disposal, leakage of and contamination by materials designated as hazardous or toxic ("Toxics"). Many materials, some utilized in everyday business activities and property maintenance, are designated as hazardous or toxic.

Some of the Laws require that Toxics be removed or cleaned up without regard to whether the party required to pay for the "clean up" caused the contamination, owned the property at the time the contamination occurred or even knew about the contamination. Some items, such as asbestos or PCB's, which were legal when installed, now are classified as Toxics, and are subject to removal requirements. Civil lawsuits for damages resulting from Toxics may be filed by third parties in certain circumstances.

Cornish & Carey Commercial Newmark Knight Frank has recommended, and hereby recommends, that each of the parties have competent professional environmental specialists review the Property and make recommended tests to that a reasonably informed assessment of these matters can be made by each of the parties. Landlord and Tenant acknowledge that neither Cornish & Carey Commercial Newmark Knight Frank nor its agents or salespersons, have been retained to investigate or to arrange for investigation by others, and have not made any recommendations or representations with regard to the presence or absence of Toxics on, in or beneath the Property. Landlord and Tenant agree that they will rely only on persons who are experts in this field and will obtain such expert advice so each of them will be as fully informed as possible with regard to Toxics in entering into this Agreement.

Although all information furnished regarding property for sale, rental, or financing is from sources deemed reliable, such information has not been verified, and no express representation is made nor is any to be implied as to the accuracy thereof, and it is submitted subject to errors, omissions, change of price, rental or other conditions, prior sale, lease or financing, or withdrawal without notice and to any special conditions imposed by our principal.

## Addendum

### 53. "Toxic Materials:

- A. Lessee shall not cause or permit to be discharged into the plumbing or sewage system of the Premises or onto the and underlying or adjacent to it, any hazardous, toxic or radioactive materials, including, but not limited to, those materials identified in Section 6680 or Title 22 of the California Administrative Code, Division 4, Chapter 30, as amended from time to time (collectively "Toxic Materials"). Lessee shall, at its sole expense, comply with any and all rules, regulations, codes, ordinances, statutes, and other requirements of lawful governmental authority respecting to Toxic Materials, pollution, harmful chemicals, and other materials in connection with Lessee's activities on or about the Premises. Lessee specifically agrees to comply with any such requirements relating to the handling, use, storage, and disposal of Toxic Materials and other materials which are considered by any such governmental authorities as harmful, dangerous, toxic, flammable, or otherwise deserving of special care. Lessee shall pay the full cost of any clean-up work performed on or about the Industrial Center as required by any governmental authority in order to remove, neutralize or otherwise treat materials of any type whatsoever directly or indirectly placed on or about the Premises by Lessee or its agents, employees, contractors, or invitees.
- B. Lessee shall be solely responsible for and shall indemnify, defend, and hold Lessor harmless from any and all claims, judgments, demands, causes or action, proceedings or hearings (collectively "Claims") relating to the storage, placement or use of Toxic Materials by Lessee, its agents or invitees on or about the Premises, including, but not limited to, Claims resulting from the contamination of subterranean water beneath, adjoining or in the vicinity of the Industrial Center. Lessee agrees to defend all such Claims on behalf of Lessor with counsel acceptable to Lessor, and to pay all fees, costs, damages, or expenses relating to or arising out of, or in connection with, any removal, clean-up, or restoration work which is required by any governmental agency having jurisdiction and which arises from Lessee's storage, use or disposal of Toxic Materials on or about the Premises during the term of this Lease, or Option Term, if exercised.

### 54. Full Disclosure:

Lessee hereby understands and acknowledges that Lessor is a partnership entity which is comprised on one or more licensed real estate broker(s) acting as principal(s) in this transaction for his (their) sole gain and profit.

### 55. Broker Representation:

Lessor and Lessee hereby acknowledge that Broker represents both parties hereto; and both parties consent thereto.

### 56. Broker Disclosure:

The parties hereby expressly acknowledge that Broker has made no independent determination or investigation regarding, but not limited to, the following: present or future use of the Property; environmental matters affecting the Property; the condition of the Property, including, but not limited to structural, mechanical and soils conditions, as well as issues surrounding hazardous wastes or substances as set out above; violations of the Occupational Safety and Health Act or any other federal, state, county or municipal laws, ordinances, or statutes; measurements of land and/or buildings. Lessee agrees to make its own investigation and determination regarding such items.

### 57. Document Preparation:

This Lease has been prepared merely as a service to Lessee and Lessor by CORNISH & CAREY COMMERCIAL NEWMARK KNIGHT FRANK REAL ESTATE and makes no representations as to the legal sufficiency or economic interpretation of this Lease. Lessee and Lessor are hereby advised to consult their personal attorneys regarding the legal aspects hereof.

### 58. Monument Signage

Signage on monument sign is available at Lessee sole cost and expense through Ron Carver at "Signs Now" (916) 455-1300.

**Addendum**

59. **Carpet, Paint and Blinds:**

It is hereby acknowledged that upon tenant occupancy of the unit the walls have been painted and the office area new carpet and new blinds.

60. **Floor Drain**

Lessee may at Lessee's sole cost and expense, and if required by the city or county of Sacramento, install a floor drain. Said floor drain shall be located in an agreed location by Landlord and Tenant. All work shall be done per code and in a professional workman like manner.

Tenant shall not be required to remove floor drain upon vacating premises.

**Agreed and Acknowledged:**

**Lessor:** KCMKC PROPERTIES, LLP

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

Lessee: OCULUS INC.

By: /s/ Jim Schutz Date: 11/3/2011  
Jim Schutz



**Amendment to Lease**

AMENDMENT TO LEASE  
 DATED AUGUST 30, 2012  
 BY AND BETWEEN KCKMC PROPERTIES, LLC ("LESSOR")  
 AND OCULUS, INC., A DELAWARE CORPORATION ("LESSEE")  
 FOR THE PROPERTY LOCATED AT  
 3045 65TH STREET, SUITE 13, SACRAMENTO, CA 95820

RECITALS

The above referenced Lease, upon mutual execution at this First Amendment, shall be modified as follows:

1. **Paragraph 1.2a-Premises.** The Premises shall include **3021 65th Street, Sacramento, California**, a ±3,000 square foot flex industrial unit.
2. **Paragraph 1.3-Term.** The term shall be extended to October 31, 2013.
3. **Paragraph 1.5-Base Rent.** The total rent per the combined units shall be Two Thousand Six Hundred Ten and 00/100 Dollars (\$2,610.00).
4. **Paragraph 1.7 (c).** The security deposit shall be increased to Two Thousand Six Hundred Ten and 00/100 Dollars (\$2,610.00).
5. **Paragraph 61-Lessor Improvements (3021 65th Street).** All electrical, plumbing, HVAC, roof, roll up and man doors, and lighting to be delivered in good working order upon lease commencement. Landlord shall confirm that the floor drains have back flow valves. Landlord shall replace stained floor and ceiling tiles. Landlord shall install new white paint in the open conditioned area.
6. **Paragraph 62-Commencement. Timing. Free Rent (3021 65th Street).** It is hereby understood that Lessor Improvements shall be completed by September 17, 2012.

Lessee shall pay upon execution of this First Amendment, the proration rent for September, Eight Hundred Forty and 00/100 Dollars (\$840.00) for the period of September 17, 2012 to September 30, 2012. The free rent period shall be October 1, 2012 to October 31, 2012. It's additionally understood that Lessee shall continue their rental obligation of Eight Hundred Ten and 00/100 Dollars (\$810.00) for 3045 65th Street, Suite 13 for October 1, 2012 to October 31, 2012. On November 1, 2012, the rent of Two Thousand Six Hundred Ten and 00/100 Dollars (\$2,610.00) shall commence.

7. **Broker Representation.** It is understood that Cornish & Carey Commercial Newmark Knight Frank represents both Lessor and Lessee in this transaction. A five percent (5%) leasing commission shall be payable by Lessor upon mutual lease execution of this First Amendment.

In case of any conflict or inconsistencies between the terms and conditions of the lease and the terms and conditions of this First Amendment, the terms and conditions of this First Amendment will govern and control.

All other terms and conditions of the Lease, unless herein specified, shall remain in full force and effect.

**Agreed and Acknowledged:**

**Lessor:** KCKMC PROPERTIES, LLC

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

**Date:** \_\_\_\_\_

**Lessee:** OCULUS, INC. A DELAWARE CORPORATION

**By:** /s/ Jim Schutz \_\_\_\_\_

**Date:** 09/06/2012 \_\_\_\_\_

Although all information furnished regarding property for sale, rental, or financing is from sources deemed reliable, such information has not been verified, and no express representation is made nor is any to be implied as to the accuracy thereof, and it is submitted subject to errors, omissions, change of price, rental or other conditions, prior sale, lease or financing, or withdrawal without notice and to any special conditions imposed by our principal.





## AMENDMENT NO. 7 TO LEASE

THIS AMENDMENT NO. 7 TO LEASE (this "Amendment") is made and entered into as of October 10, 2012, by and between 1125-1137 NORTH MCDOWELL, LLC, a Delaware limited liability company ("Landlord"), and OCULUS INNOVATIVE SCIENCES, INC., a Delaware corporation ("Tenant").

## RECITALS

- A. Landlord (as successor in interest to RNM Lakeville, L.P., a California limited partnership) and Tenant (formerly known as MicroMed Laboratories, Inc., a California corporation) are parties to that certain Lease dated October 26, 1999 (the "**Original Lease**"), which Original Lease has been previously amended by that certain Amendment No. 1 to Lease dated as of September 15, 2000, that certain Amendment No. 2 to Lease dated as of July 29, 2005, that certain Amendment No. 3 to Lease dated as of August 23, 2006, that certain Amendment No. 4 to Lease dated as of September 13, 2007, that certain Amendment No. 5 to Lease dated as of May 18, 2009, and that certain Amendment No. 6 to Lease dated as of April 26, 2011 (collectively, the "**Lease**"). Pursuant to the Lease, Landlord has leased to Tenant space currently containing approximately **13,840** rentable square feet (the "**Premises**") described as 1129 North McDowell Boulevard, Petaluma, California 94954 of the building located at 1125-1137 North McDowell Boulevard, Petaluma, California 94954 (the "**Building**").
- B. The Lease by its terms shall expire on September 30, 2014 ("**Prior Termination Date**"), and the parties desire to extend the Term of the Lease, all on the following terms and conditions.

**NOW, THEREFORE**, in consideration of the mutual covenants and agreements herein contained and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Landlord and Tenant agree as follows:

1. **Extension.** The Term of the Lease is hereby extended for a period of thirty-six (36) months and shall expire on September 30, 2017 ("**Sixth Extended Termination Date**"), unless sooner terminated in accordance with the terms of the Lease. That portion of the Term commencing the day immediately following the Prior Termination Date ("**Sixth Extension Date**") and ending on the Sixth Extended Termination Date shall be referred to herein as the "**Sixth Extended Term**". Tenant shall have no further renewal option under the Lease.
2. **Base Rent.** For the period commencing as of the Sixth Extension Date and continuing until the Sixth Extended Termination Date, Tenant shall pay Base Rent in an amount equal to \$11,072.00 per month with respect to the Premises. All such Base Rent shall be payable by Tenant in accordance with the terms of the Lease, as amended hereby.
3. **Additional Rent.** For the period commencing on the Sixth Extension Date and ending on the Sixth Extended Termination Date, Tenant shall pay all Additional Rent payable under the Lease, including Tenant's Share of Operating Expenses and Real Property Taxes, in accordance with the terms of the Lease, as amended hereby.
4. **Security Deposit.** No additional Security Deposit shall be required in connection with this Amendment. Tenant hereby waives any and all rights under and benefits of 1950.7 of the California Civil Code, or any similar or successor law now or hereinafter in effect
5. **Improvements to Premises.**

- 5.1 **Condition of Premises.** Tenant is in possession of the Premises and accepts the same "as is" without any agreements, representations, understandings or obligations on the part of Landlord to perform any alterations, repairs or improvements, except as may be expressly provided otherwise in this Amendment.
- 5.2 **Responsibility for Improvements to Premises.** Tenant may perform improvements to the Premises in accordance with the **Exhibit A** attached hereto and Tenant shall be entitled to an improvement allowance in connection with such work as more fully described in **Exhibit A**.
6. **Other Pertinent Provisions.** Landlord and Tenant agree that, effective as of the date of this Amendment (unless different effective date(s) is/are specifically referenced in this Section), the Lease shall be amended in the following additional respects:
- 6.1 **Landlord's Address.** Landlord's Address set forth in the Original Lease is hereby deleted in its entirety and replaced by the following:
- 1125-1137 North McDowell, LLC  
c/o Investcorp International, Inc.  
280 Park Avenue, 36th Floor  
New York, New York 10017  
Attention: Michael O'Brien and Juliana Priest
- With a copy to:
- Investcorp International, Inc.  
c/o Veritas Property Management  
1600 Corporate Circle  
Petaluma, California 94954  
Attention: Property Manager
- 6.2 **Remedies.** TENANT HEREBY WAIVES ANY AND ALL RIGHTS CONFERRED BY SECTION 3275 OF THE CIVIL CODE OF CALIFORNIA AND BY SECTIONS 1174 (c) AND 1179 OF THE CODE OF CIVIL PROCEDURE OF CALIFORNIA AND ANY AND ALL OTHER LAWS AND RULES OF LAW FROM TIME TO TIME IN EFFECT DURING THE TERM, AS AMENDED HEREBY, PROVIDING THAT TENANT SHALL HAVE ANY RIGHT TO REDEEM, REINSTATE OR RESTORE THE LEASE FOLLOWING ITS TERMINATION BY REASON OF TENANT'S BREACH.
- 6.4 **Tenant Entity Name Correction.** References to Tenant in the Lease as "Oculus Innovative Sciences, Inc., a California corporation" are in error and the parties hereto acknowledge and agree that the definition of Tenant is as is stated in this Amendment. Oculus Innovative Sciences, Inc., a Delaware corporation hereby ratifies the Lease and agrees that it is bound by all terms and conditions of the Lease as of the original lease execution date, in the same manner and to the same extent as though the correct tenant name had been reflected therein.
- 6.5 **Deletion.** Paragraph 27 (Right of First Refusal) of the Addendum to the Original Lease is hereby deleted in its entirety and of no further force and effect.
7. **Miscellaneous.**
- 7.1 This Amendment, including **Exhibit A** (Tenant Alterations) attached hereto, sets forth the entire agreement between the parties with respect to the matters set forth herein. There have been no additional oral or written representations or agreements. Under no circumstances shall Tenant be entitled to any rent abatement, improvement allowance, leasehold improvements, or other work to the Premises, or any similar economic incentives that may have been provided Tenant in connection with entering into the Lease, unless specifically set forth in this Amendment.

- 7.2 Except as herein modified or amended, the provisions, conditions and terms of the Lease shall remain unchanged and in full force and effect. In the case of any inconsistency between the provisions of the Lease and this Amendment, the provisions of this Amendment shall govern and control. The capitalized terms used in this Amendment shall have the same definitions as set forth in the Lease to the extent that such capitalized terms are defined therein and not redefined in this Amendment.
- 7.3 Submission of this Amendment by Landlord is not an offer to enter into this Amendment but rather is a solicitation for such an offer by Tenant. Landlord shall not be bound by this Amendment until Landlord has executed and delivered the same to Tenant.
- 7.4 Tenant hereby represents to Landlord that Tenant has dealt with no broker in connection with this Amendment. Tenant agrees to indemnify and hold Landlord and its members, principals, beneficiaries, partners, officers, directors, employees, mortgagee(s) and agents, and the respective principals and members of any such agents harmless from all claims of any brokers claiming to have represented Tenant in connection with this Amendment.
- 7.5 Each signatory of this Amendment represents hereby that he or she has the authority to execute and deliver the same on behalf of the party hereto for which such signatory is acting. Tenant hereby represents and warrants that neither Tenant, nor any persons or entities holding any legal or beneficial interest whatsoever in Tenant, are (i) the target of any sanctions program that is established by Executive Order of the President or published by the Office of Foreign Assets Control, U.S. Department of the Treasury ("**OFAC**"); (ii) designated by the President or OFAC pursuant to the Trading with the Enemy Act, 50 U.S.C. App. § 5, the International Emergency Economic Powers Act, 50 U.S.C. §§ 1701-06, the Patriot Act, Public Law 107-56, Executive Order 13224 (September 23, 2001) or any Executive Order of the President issued pursuant to such statutes; or (iii) named on the following list that is published by OFAC: "List of Specially Designated Nationals and Blocked Persons." If the foregoing representation is untrue at any time during the Term (as extended), an event of default under the Lease will be deemed to have occurred, without the necessity of notice to Tenant.
- 7.6 The obligations of Landlord under the Lease, as amended hereby, are not intended to and shall not be personally binding on, nor shall any resort be had to the private properties of, any of its trustees or board of directors and officers, as the case may be, its investment manager, the general partners thereof, or any beneficiaries, stockholders, employees, or agents of Landlord or the investment manager, and in no case shall Landlord be liable to Tenant hereunder for any lost profits, damage to business, or any form of special, indirect or consequential damage.

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, Landlord and Tenant have entered into and executed this Amendment as of the date first written above.

LANDLORD:

**1125-1137 NORTH MCDOWELL, LLC,  
a Delaware limited liability company**

By: /s/ F. Jonathan Dracos  
Name: F. Jonathan Dracos  
Title: President

TENANT:

**OCULUS INNOVATIVE SCIENCES, INC.,  
a Delaware corporation**

By: /s/ Robert E. Miller  
Name: Robert E. Miller  
Title: CFO

## EXHIBIT A- TENANT ALTERATIONS

attached to and made a part of the Amendment dated as of October 10, 2012,  
between 1125-1137 NORTH MCDOWELL, LLC, a Delaware limited liability company, as Landlord and  
OCULUS INNOVATIVE SCIENCES, INC., a Delaware corporation, as Tenant

1. Tenant, following the full and final execution and delivery of the Amendment to which this **Exhibit A** is attached, shall have the right upgrade the heating, ventilation and air conditioning (HVAC) system serving the Premises (the "**Tenant Alterations**"). Notwithstanding the foregoing, Tenant and its contractors shall not have the right to perform the Tenant Alterations in the Premises unless and until Tenant has complied with all of the terms and conditions of Paragraph 10.2 of the Original Lease, including, without limitation, approval by Landlord of the final plans for the Tenant Alterations and the contractors to be retained by Tenant to perform such Tenant Alterations. Tenant shall be responsible for all elements of the design of Tenant's plans (including, without limitation, compliance with law, functionality of design, the structural integrity of the design, the configuration of the Premises and the placement of Tenant's furniture, appliances and equipment), and Landlord's approval of Tenant's plans shall in no event relieve Tenant of the responsibility for such design. In addition to the foregoing, Tenant shall be solely liable for all costs and expenses associated with or otherwise caused by Tenant's performance and installment of the Tenant Alterations (including, without limitation, any legal compliance requirements arising outside of the Premises). Landlord's approval of the contractors to perform the Tenant Alterations shall not be unreasonably withheld. The parties agree that Landlord's approval of the general contractor to perform the Tenant Alterations shall not be considered to be unreasonably withheld if any such general contractor (a) does not have trade references reasonably acceptable to Landlord, (b) does not maintain insurance as required pursuant to the terms of the Lease, (c) does not provide current financial statements reasonably acceptable to Landlord, or (d) is not licensed as a contractor in the state/municipality in which the Premises is located. Tenant acknowledges the foregoing is not intended to be an exclusive list of the reasons why Landlord may reasonably withhold its consent to a general contractor. Notwithstanding anything to the contrary contained in the Lease, Landlord shall not require the general contractor to provide Landlord a payment and performance bond for the estimated cost of the Tenant Alterations.

2. Provided Tenant is not in default under the Lease, as amended, Landlord agrees to contribute the sum of \$75,000.00 (the "**Allowance**") toward the cost of performing the Tenant Alterations. The Allowance may be used for the cost of preparing design and construction documents, permit fees, and mechanical and electrical plans for the Tenant Alterations and for hard costs in connection with the Tenant Alterations. The Allowance shall be paid to Tenant or, at Landlord's option, to the order of the general contractor that performed the Tenant Alterations, within thirty (30) days following receipt by Landlord of (a) receipted bills covering all labor and materials expended and used in the Tenant Alterations; (b) a sworn contractor's affidavit from the general contractor and a request to disburse from Tenant containing an approval by Tenant of the work done; (c) full and final waivers of lien; (d) if applicable due to the nature of the Tenant Alterations, as-built plans of the Tenant Alterations; and (e) the certification of Tenant and its architect that the Tenant Alterations have been installed in a good and workmanlike manner in accordance with the approved plans, and in accordance with applicable laws, codes and ordinances. The Allowance shall be disbursed in the amount reflected on the receipted bills meeting the requirements above. Notwithstanding anything herein to the contrary, Landlord shall not be obligated to disburse any portion of the Allowance during the continuance of an uncured default under the Lease, and Landlord's obligation to disburse shall only resume when and if such default is cured.

3. In no event shall the Allowance be used for the purchase of equipment (other than the HVAC system), furniture or other items of personal property of Tenant. If Tenant does not submit a request for payment of the entire Allowance to Landlord in accordance with the provisions contained in this **Exhibit A** by June 30, 2013, any unused amount shall accrue to the sole benefit of Landlord, it being understood that Tenant shall not be entitled to any credit, abatement or other concession in connection therewith. Tenant shall be responsible for all applicable state sales or use taxes, if any, payable in connection with the Tenant Alterations and/or Allowance. Notwithstanding anything to the contrary contained in the Lease, Landlord shall not charge a construction management fee for Landlord's oversight of the Tenant Alterations.

4. Tenant agrees to accept the Premises in its "as-is" condition and configuration, it being agreed that Landlord shall not be required to perform any work or, except as provided above with respect to the Allowance, incur any costs in connection with the construction or demolition of any improvements in the Premises.

5. This **Exhibit A** shall not be deemed applicable to any additional space added to the Premises at any time or from time to time, whether by any options under the Lease or otherwise, or to any portion of the original Premises or any additions to the Premises in the event of a renewal or extension of the original Term of the Lease, whether by any options under the Lease or otherwise, unless expressly so provided in the Lease or any amendment or supplement to the Lease.

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

I, Hojabr Alimi, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Oculus Innovative Sciences, Inc. for the quarter ended September 30, 2012;
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-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2012

By: /s/ Hojabr Alimi  
Hojabr Alimi  
Chief Executive Officer  
(Principal Executive Officer)

**CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT TO  
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002  
(18 U.S.C. SECTION 1350)**

I, Robert Miller, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Oculus Innovative Sciences, Inc. for the quarter ended September 30, 2012;
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-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 8, 2012

By: /s/ Robert Miller  
Robert Miller  
Chief Financial Officer  
(Principal Financial Officer and Principal  
Accounting Officer)



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

Pursuant to section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of section 1350, chapter 63 of title 18, United States Code), the undersigned officers of Oculus Innovative Sciences, Inc., a Delaware corporation (the "Company"), do hereby certify, to such officers' knowledge, that:

The Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 (the "Form 10-Q") of the Company fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and the information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 8, 2012

By: /s/ Hojabr Alimi  
Hojabr Alimi  
Chief Executive Officer  
(Principal Executive Officer)

Date: November 8, 2012

By: /s/ Robert Miller  
Robert Miller  
Chief Financial Officer  
(Principal Financial Officer and Principal  
Accounting Officer)