

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

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended: December 31, 2006

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)

Commission File Number 000-51531

SUNESIS PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

94-3295878
(I.R.S. Employer
Identification Number)

341 Oyster Point Boulevard
South San Francisco, California 94080
(Address of principal executive offices, including zip code)

(650) 266-3500
(Registrant's telephone number, including area code)
Securities registered pursuant to Section 12(b) of the Act:

<u>Title of Each Class:</u> Common Stock, par value \$0.0001 per share	<u>Name of Each Exchange on Which Registered:</u> The NASDAQ Stock Market LLC
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Securities registered pursuant to Section 12(g) of the Act:

None
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

The aggregate market value of Common Stock held by non-affiliates of the Registrant, based on the last sale price for such stock on June 30, 2006, was \$148,602,666.

The total number of shares outstanding of the Registrant's common stock, \$0.0001 par value per share, as of March 1, 2007, was 29,459,157.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's Definitive Proxy Statement, to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the 2007 Annual Meeting of Stockholders of Sunesis Pharmaceuticals, Inc. (hereinafter referred to as "Proxy Statement") are incorporated by reference in Part III of this report. Such Proxy Statement will be filed with the Securities and Exchange Commission not later than 120 days after the conclusion of the registrant's fiscal year ended December 31, 2006.

SUNESIS PHARMACEUTICALS, INC.

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PART I

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report, including the information we incorporate by reference, contains forward-looking statements that involve substantial risks and uncertainties. All statements, other than statements of historical fact, included in this report regarding our strategy, future operations, future financial position, future revenue, projected costs, prospects, plans and objectives of management are forward-looking statements. The words “anticipate,” “believe,” “estimate,” “expect,” “hope,” “intend,” “may,” “plan,” “project,” “will,” “would” and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements we make. We have included in this report, particularly in the “Risk Factors” section, important factors that we believe could cause actual results or events to differ materially from the forward-looking statements that we make. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, capital raising or in-licensing transactions, joint ventures or investments we may make. We do not assume any obligation to update any forward-looking statements.

ITEM 1. BUSINESS

General


We are a clinical-stage biopharmaceutical company focused on the discovery, development and commercialization of novel, small molecule therapeutics for use in oncology and other unmet medical needs. We have built our product candidate portfolio through internal discovery and the in-licensing of novel cancer therapeutics. We are advancing our product candidates through in-house research and development efforts and strategic collaborations with leading pharmaceutical and biopharmaceutical companies. We believe the quality and breadth of our product candidate pipeline, platform technology, strategic collaborations and scientific team will enable us to become a fully integrated biopharmaceutical company with a diversified portfolio of novel therapeutics for major diseases.

We are advancing three proprietary oncology product candidates, SNS-595, SNS-032 and SNS-314, through in-house research and development efforts. Our lead product candidate, SNS-595, is a novel cell cycle inhibitor. With SNS-595, we are currently conducting one Phase 2 clinical trial in small cell lung cancer, one Phase 2 clinical trial in ovarian cancer, and one Phase 1 clinical trial in acute leukemias. In January 2007, we announced that we are terminating enrollment for our Phase 2 clinical trial in non-small cell lung cancer and progressing to the second stage in our Phase 2 clinical trial in small cell lung cancer. In 2007, we expect to initiate a Phase 1 clinical trial in acute leukemias in combination with cytarabine, and a Phase 2 clinical trial in acute myelogenous leukemia, or AML. We in-licensed SNS-595 from Dainippon Sumitomo Pharma Co., Ltd., or Dainippon, in October 2003. Our second most advanced product candidate, SNS-032, is a cyclin-dependent kinase, or CDK, inhibitor. We are currently conducting a Phase 1 clinical trial with SNS-032 in patients with advanced solid tumors. We are also conducting a Phase 1 clinical trial in patients with advanced B-cell lymphoid malignancies. We in-licensed SNS-032 from Bristol-Myers Squibb, or BMS, in April 2005. We are also developing SNS-314, an Aurora kinase inhibitor, for the treatment of cancer, and in February 2007, we filed an investigational new drug application, or IND, for this compound. We have worldwide development and commercialization rights to SNS-595, SNS-032 (for diagnostic and therapeutic applications) and SNS-314. We may in the future enter into collaborations to maximize the commercial potential of these programs.

We have developed a proprietary method of discovering drugs in pieces, or fragments. We call this fragment-based discovery approach “Tethering®.” Tethering® is a process whereby a target protein

known to be involved in a disease process is engineered to facilitate the binding of small drug fragments. Once a small fragment is identified, the fragment is built out using the target protein’s surface as a template to make a new full-size therapeutic compound. We combine Tethering® with other drug discovery tools, such as structure-based design and medicinal chemistry, to discover and develop novel therapeutics for major diseases. In addition to its use in our internal drug discovery efforts, Tethering® is the basis of our four ongoing strategic collaborations with Biogen Idec, Johnson & Johnson PRD and Merck. We believe that our strategic collaborations will enable us to leverage and expand our internal development capabilities, manage our cash expenditures and diversify risk across our pipeline.

We were incorporated in Delaware in February 1998 as Mosaic Pharmaceuticals, Inc., and we subsequently changed our name to Sunesis Pharmaceuticals, Inc. Our offices are headquartered at 341 Oyster Point Boulevard, South San Francisco, California 94080, and our telephone number is (650) 266-3500. Our website address is www.sunesis.com. Information contained in, or accessible through, our website is not a part of this report. References in this report to “we,” “us,” “our,” “our company” or “Sunesis” refer to Sunesis Pharmaceuticals, Inc.

Sunesis, Tethering® and , our logo are registered trademarks of our company. All other trademarks, trade names and service marks appearing in this report are the property of their respective owners.

Our Programs

SNS-595 Program

SNS-595 is a novel cell-cycle inhibitor that we believe represents a new class of anti-tumor drugs. The process of cell division is tightly regulated in order to control growth. In cancer, this cell regulation has been circumvented, and cancer cell proliferation is unrestrained. We believe that SNS-595 causes cancer cells to arrest during cell division and consequently, under programmed cell death or apoptosis. In preclinical studies, SNS-595 demonstrated broad anti-tumor activity.

Since 2004, we have conducted two Phase 1 clinical trials to evaluate doses and schedules of administration in patients with advanced solid tumors. In October 2005, we began a Phase 1 clinical trial in acute leukemias. In December 2005, we commenced a Phase 2 clinical trial in non-small cell lung cancer for which we recently announced that we are terminating enrollment. We also initiated a Phase 2 clinical trial in small cell lung cancer in March 2006 which we recently announced will progress to the second stage of the study. Lastly, in December 2006, we initiated a Phase 2 clinical trial in ovarian cancer. In addition, in 2007, we expect to initiate a Phase 1 clinical trial in acute leukemias in combination with cytarabine, and a Phase 2 clinical trial in AML. We obtained worldwide development and commercialization rights to SNS-595 from Dainippon through a license agreement in 2003.

SNS-032 Program

SNS-032 is a targeted inhibitor of certain cyclin-dependent kinases, including CDK2, CDK7 and CDK9. Kinases are enzymes critical in the communication and relay of signals to promote cell growth and function, and cyclin-dependent kinases relay signals in the cell cycle. SNS-032 is a novel targeted inhibitor of CDKs 2, 7 and 9, which are critical in the communication and relay of signals to promote cellular growth and function. CDK2 is involved in cellular proliferation by regulating the initiation of and progression through the DNA-synthesis phase of the cell cycle. CDK7 and CDK9 are involved in transcriptional regulation of certain proteins involved in cell survival. Inappropriate activity by these CDKs can lead to unregulated proliferation, avoidance of apoptosis and increased cell survival, all of which are hallmarks of cancer. By selectively targeting these CDKs, SNS-032 may halt both aberrant cell proliferation and induce apoptosis. In preclinical studies, SNS-032 has demonstrated broad anti-tumor activity in multiple mouse and human tumor models, including breast, ovarian, colorectal and skin cell cancers. BMS conducted three

Phase 1 dose-escalation clinical trials evaluating the safety and tolerability of SNS-032 at three different dosing regimens in approximately 135 patients with refractory solid tumors. In January 2006, we commenced a Phase 1 clinical trial with SNS-032. We designed this trial to evaluate the safety and tolerability of daily, repeated exposures to SNS-032 as a stand-alone therapy in patients with advanced solid tumors. We expect to release results of this Phase 1 clinical trial in the first half of 2007. In March 2007, we commenced a Phase 1 clinical trial with SNS-032 in B-cell lymphoid malignancies. We obtained worldwide rights to develop and commercialize SNS-032 for diagnostic and therapeutic applications from BMS through a license agreement in April 2005.

SNS-314 Program

SNS-314 is a targeted inhibitor of the Aurora A, B and C kinases. Aurora kinases are key enzymes involved in cell growth and division and play an essential role in the abnormal growth and proliferation of tumor cells. The goal of this program is to develop novel Aurora kinase inhibitors that exhibit broad activity in tumors and do not cause significant peripheral nerve cell death, known as peripheral neuropathy. We filed an IND in February 2007 and expect to commence a Phase 1 clinical trial in the second quarter of 2007. We have retained worldwide rights to commercialize SNS-314.

Other Oncology Kinase Programs

We are applying Tethering® in several programs to discover and develop novel cancer therapeutics that inhibit other kinases.

Raf Kinase Inhibitors Program. We are developing our Raf kinase inhibitors program in collaboration with Biogen Idec. We provided Raf kinase inhibitors to the collaboration and have jointly with Biogen Idec optimized these molecules to show oral antitumor activity in animal models. Raf kinase is an enzyme in the Ras pathway, a signaling pathway important to cell proliferation. The goal of this program is to develop Raf kinase inhibitors with improved pharmaceutical properties as compared to other Raf kinase inhibitors in development. We expect to select a compound for good laboratory practice, or GLP, preclinical development in late 2007.

Other Kinase Inhibitors Programs. As part of our collaboration with Biogen Idec, we are applying Tethering® to discover novel small molecule leads that inhibit up to five additional oncology and immunology kinase targets. We and Biogen Idec are working together on the identification, optimization and development of inhibitor drugs for these kinases. We have an option to co-develop and co-promote the product candidates from two of the collaboration kinase targets, including Raf, developed through this program on a worldwide basis. We are also working on the identification and optimization of kinase inhibitor drugs outside of our collaboration with Biogen Idec.

Other Programs

Cathepsin S Inhibitors Program for Inflammatory Diseases. In collaboration with Johnson & Johnson PRD, we applied Tethering® to discover small molecule inhibitors of Cathepsin S, an enzyme involved in the activation of T-cells. Inappropriate activation of T-cells may lead to some inflammatory diseases, such as asthma, rheumatoid arthritis, multiple sclerosis, psoriasis and Crohn's disease. Although the research term of this collaboration ended in December 2005, our agreement with Johnson & Johnson PRD continues so long as a compound arising from the collaboration is the subject of an active development project or for so long as there is an obligation to pay royalties under the agreement. Several collaboration compounds continue to be evaluated in preclinical studies and are the subject of an active development project. Johnson & Johnson PRD holds worldwide rights to commercialize any drugs resulting from this program.

BACE Inhibitors for Alzheimer's Disease. We collaborated with Merck to identify and optimize inhibitors of BACE, an important enzyme target in Alzheimer's disease. The research term of this collaboration ended in February 2006. Merck is responsible for advancing these compounds into lead optimization, preclinical studies and clinical trials, and collaboration compounds continue to be advanced in preclinical studies. Merck holds worldwide rights to commercialize any drugs resulting from this program.

Anti-Viral Inhibitors Program. We are collaborating with Merck to identify novel small molecule inhibitors of an anti-viral target. We have licensed to Merck a series of small molecule compounds we derived from Tethering® that target a specific viral protein. Merck holds worldwide rights to commercialize any drugs resulting from this collaboration and is responsible for advancing these compounds into lead optimization, preclinical studies and clinical trials.

Anti-Cancer Program. We collaborated with Biogen Idec to identify novel small molecule inhibitors of a non-kinase cancer target. We provided Biogen Idec with a series of small molecule compounds we derived from Tethering® that target a specific protein overexpressed in certain cancers, including breast

and colorectal cancers. Biogen Idec holds worldwide rights to commercialize any drugs resulting from this collaboration and is responsible for advancing these compounds into lead optimization, preclinical studies and clinical trials. This program is no longer being actively pursued by Biogen Idec.

LFA-1 Program. We internally identified a series of small-molecule antagonists to the cell adhesion molecule LFA-1, an extracellular receptor found on white blood cells that mediates both migration and adhesion of the white blood cells to sites of inflammation as a part of the body's immune response. LFA-1 antagonists have promise as therapeutic agents for immunological and inflammatory diseases including psoriasis, chronic dry eye, and multiple sclerosis. We discontinued development of our LFA-1 antagonist program in 2004 when we focused our research and development efforts in oncology. We licensed to SARcode worldwide rights to all of our LFA-1 patents and related know-how in March 2006.

Our Fragment-Based Drug Discovery Approach

We are applying Tethering® to discover and develop novel therapeutics for major diseases. Tethering® allows us to screen drug fragments based on binding properties, which enables us to potentially identify compounds that may not be discovered through conventional methods of drug discovery. We believe that this capability allows us to efficiently design product candidates that bind to sites or regions on a specific protein not readily accessed by other discovery methods. Tethering® is applicable to most proteins, and we have used Tethering® on over 15 different protein targets to date.

Corporate Strategy

We are focused on discovering, developing and commercializing novel small molecule therapeutics for oncology and other unmet medical needs. The key elements of our strategy are as follows:

- focus on small molecules with differentiated therapeutic benefits;
- maximize the value of our pipeline of product candidates through internal development and strategic collaborations; and
- expand our portfolio of product candidates through our internal drug discovery engine and selective in-licensing.

Manufacturing and Raw Materials

We outsource the manufacture of SNS-595 to third-party contract manufacturers. The active pharmaceutical ingredient, or API, of SNS-595 is manufactured by a single-source supplier through a

13-step convergent synthesis in which two intermediates are manufactured in a parallel process and then combined and deprotected in the final two steps. The API is then formulated and vials are filled and finished by two different third party manufacturers. The API is classified as a toxic substance, which limits the number of suppliers qualified to manufacture it. We have a sufficient supply of SNS-595 API to conduct our current and planned non-pivotal Phase 1 and Phase 2 clinical trials in North America. Our current inventory of SNS-595 finished product is suitable for use through the third quarter of 2009. New lots of finished product will be manufactured and released as required to support our current and planned clinical activities.

We outsource the manufacture of SNS-032 to third-party contract manufacturers. As part of our agreement with BMS, we acquired enough of the API of SNS-032 for at least our Phase 1 clinical trial for SNS-032. Methods for preparing and testing SNS-032 API have been transferred to our API contract manufacturer, and we have released a Good Manufacturing Practice, or GMP, batch of SNS-032. Methods for preparing and testing the corresponding drug product, SNS-032 API, have also been transferred to our finished product manufacturer and we have released a clinical batch of SNS-032 API drug product which is now supporting our clinical trial. We have a sufficient supply of SNS-032 to conduct our current and planned Phase 1 and Phase 2 clinical trials. Our current inventory of SNS-032 finished product is suitable for use through at least the fourth quarter of 2007. New lots of finished product will be manufactured and released as required to support our current and planned clinical activities.

Methods for manufacturing and testing SNS-314 API have been transferred to our API contract manufacturer and we have manufactured and released a GMP batch of SNS-314. Methods for preparing and testing the corresponding drug product, SNS-314 API, have also been transferred to our finished product manufacturer and we have released a clinical batch of SNS-314 API which will be used to support our planned clinical trial.

License Agreements

Dainippon Sumitomo Pharma

In October 2003, we entered into a licensing agreement with Dainippon in which we obtained a worldwide, exclusive license, including the right to sublicense, to SNS-595 and related compounds.

In addition to upfront payments and milestone payments made as of December 31, 2006, the agreement provides to Dainippon future milestone payments of up to \$8.0 million for starting Phase 3 clinical testing, and for filing new drug applications, or NDAs, and receiving regulatory approval in the United States, Europe and Japan for cancer treatment. In February 2006, we paid Dainippon a \$500,000 milestone payment related to the commencement of our Phase 2 clinical trial in non-small cell lung cancer. If SNS-595 is approved for a non-cancer indication, additional milestone payments become payable to Dainippon.

The agreement also provides for royalty payments to Dainippon at rates that are based on total annual net sales. We may reduce our royalty payments to Dainippon if a third party markets a competitive product or we must pay royalties for third party intellectual property rights necessary to commercialize SNS-595. Royalty obligations under the agreement continue on a country-by-country and product-by-product basis until the later of the date on which no valid patent claims relating to a product exist or 10 years from the date of the first sale of the product.

If we discontinue seeking regulatory approval and/or sale of the product in a region, we are required to return to Dainippon its rights to the product in that region. The agreement may be terminated by either party for the other party's uncured breach or bankruptcy.

In April 2005, we entered into a license agreement with Bristol-Myers Squibb, or BMS, in which we obtained worldwide exclusive and non-exclusive diagnostic and therapeutic licenses, including rights to sublicense, to SNS-032 and any related compounds that are active against CDK-1, -2, -4, -7 and -9 and are covered by licensed intellectual property.

In April 2005, we paid BMS an \$8.0 million upfront payment through the issuance of shares of our Series C-2 preferred stock which converted into 879,094 shares of common stock upon our initial public offering, or IPO, in September 2005. Under the terms of the agreement, we are obligated to make milestone payments to BMS of up to \$29.0 million in cash and equity based on the successful development and approval for the first indication and formulation of SNS-032. Additional development and commercialization milestones could total up to \$49.0 million in cash and equity totaling up to \$78.0 million for beginning Phase 1, Phase 2 and Phase 3 clinical testing, and for filing NDAs and receiving regulatory approval in the United States, Europe and Japan as well as for achieving certain commercial milestones. Milestone payments are distributed among intravenous, or IV, and oral formulations and various cancer indications. We may, at our election, pay some of the initial milestone payments in equity or a mixture of cash and equity, rather than entirely in cash. Shares of our stock issued in connection with milestone payments will be valued at the average closing price of our common stock for a specified five-day period prior to issuance. In February 2006, as consideration for a \$2.0 million milestone payment due pursuant to the license agreement for initiating a Phase 1 clinical trial, we issued an aggregate of 404,040 shares of our common stock to BMS.

The agreement also provides for royalty payments to BMS at rates that are based on total annual net sales. Royalty obligations under the agreement continue on a country-by-country basis until the later of (i) expiration of all patents that are owned by us or exclusively licensed to us (whether by BMS or a third party) that cover a licensed product, (ii) 10 years following the first commercial sale of a licensed product, or (iii) expiration of all applicable data exclusivity with respect to a licensed product. The U.S. composition of matter patent covering SNS-032 is due to expire on October 21, 2018, and most of its foreign counterparts are due to expire on December 7, 2020.

After completion of any Phase 2 clinical trial with SNS-032 or other licensed product under an IND, should we desire to sublicense our rights under the agreement, BMS will have the first right to negotiate with us for such sublicense. If we and BMS do not reach agreement within a designated period of time, then we are free to sublicense to any third party provided the financial terms are not less favorable than those offered to BMS. We cannot grant a sublicense to any third party before the completion of such Phase 2 clinical trial unless we receive BMS' consent.

The agreement may be terminated by BMS for our uncured breach (other than a diligence breach) or bankruptcy. BMS may terminate this agreement on a country-by-country basis for our uncured failure to use commercially reasonable efforts to develop and/or commercialize at least one licensed compound or licensed product in a particular country or territory. Further, if such uncured failure occurs in certain countries, BMS may terminate the agreement as to entire designated territories. BMS may also terminate the agreement if we develop or market a competitive product within certain designated time periods. We may terminate this agreement with respect to a specific licensed product in a particular country without cause but with a specified notice period. We may also terminate the agreement for BMS' uncured breach.

The University of California, San Francisco

In August 2005, and amended in April 2006, we entered into research and license agreements with the University of California, San Francisco, or UCSF, that allows UCSF a limited license to use Tethering® for academic purposes. UCSF intends to leverage Tethering® to identify novel, small molecule drug candidates. In return, we received an exclusive royalty-free license to any improvements to Tethering® or

fragment libraries that emerge from UCSF's research. In the event that any small molecules are discovered using Tethering®, we will have a right of first negotiation to in-license the compounds. UCSF is precluded from utilizing the technology for commercial purposes and from conducting research in the kinase field or any other drug target on which our company is currently interested. The research at UCSF is being conducted by Dr. James Wells. Dr. Wells was a founder of our company and is a member of our board of directors.

SARcode, Inc.

In March 2006, and amended in December 2006, the Company entered into a license agreement with SARcode, Inc., or SARcode, a privately-held biopharmaceutical company, that provides SARcode a license to our LFA-1 inhibitor program. SARcode intends to use the license to develop small molecule drugs to treat inflammatory diseases. We had previously discontinued our LFA-1 inhibitor program, which is outside of our strategic focus on discovering and developing novel small molecule therapeutics to treat cancer.

In conjunction with the license, in January 2007 we received a \$250,000 license fee and a \$250,000 note convertible into preferred stock in certain circumstances. Under the terms of the license agreement, SARcode received an exclusive, worldwide license to all of our LFA-1 patents and related know-how. In addition to cash and convertible notes already received, we may in the future receive up to \$1.0 million in license fees and convertible notes, \$31.0 million in development and marketing milestone payments, and royalties for the commercialization of a licensed compound.

Strategic Collaborations

As of February 28, 2007, we had four ongoing strategic collaborations, one of which involves active participation by our personnel, with three leading pharmaceutical and biopharmaceutical companies. These alliances have been designed to enable us to leverage and expand our internal development capabilities, manage our cash expenditures and diversify risk across our pipeline. Through our strategic collaborations, we are able to pursue more programs than we could fund on our own. As of December 31, 2006, we had received an aggregate of approximately \$74.1 million in cash in the form of stock purchase proceeds and fees from our current and former collaboration partners, excluding Biogen Idec's \$5.0 million investment in our company through our IPO.

In forming each of our strategic collaborations, we have agreed for a certain period of time not to conduct certain research, independently or with any commercial third party, that is on the same target as that covered by the collaboration agreement. Some of our collaborations also significantly restrict our ability to utilize intellectual property derived from a collaboration for a purpose outside of the collaboration.

Biogen Idec (formerly Biogen, Inc.)—TNF Family and Oncology Research Collaboration

In December 2002, we entered into a collaboration with Biogen Idec to apply Tethering® to discover and develop small molecule modulators of up to four members of the TNF trimeric cytokine super-family plus up to two additional targets. The research phase of this collaboration ended in June 2005, and to our knowledge Biogen Idec has discontinued the development of all product candidates that were subject to this collaboration.

Pursuant to this agreement, we received a \$3.0 million upfront technology access fee. In addition, Biogen Idec made a \$6.0 million equity investment in our company. The agreement also provided for a maintenance fee payable to us of \$357,500 per quarter, starting in April 2004 and continuing until the end of the initial research phase which ended in July 2005. Both parties agreed to dedicate resources as

provided in the research plan. To date, we have received payments totaling \$10.8 million under this collaboration, net of \$4.0 million in loan proceeds which were repaid in full in September 2005.

Biogen Idec—Kinase Research, Development and Commercialization Collaboration

In August 2004, we entered into a collaboration agreement with Biogen Idec to discover, develop and commercialize small molecule inhibitors of Raf kinase and up to five additional targets. The primary focus of the program is to discover small molecule inhibitors of kinases that play a role in oncology and immunology indications or in the regulation of the human immune system. During the research term, we and Biogen Idec agreed to work together exclusively to develop pharmaceutical compounds against collaboration targets with the exception that either party may collaborate with a third party on a Phase 2 clinical trial or later stage compound against a collaboration target. Our exclusivity obligation continues for an additional year after the end of the research term. We also agreed not to develop or commercialize any compound active against a collaboration target that is the subject of the agreement.

Pursuant to this agreement, we received a \$7.0 million upfront technology access fee. In addition, Biogen Idec made a \$14.0 million equity investment in our company. As of December 31, 2006, we had received payments totaling \$33.5 million under this collaboration, including the \$14.0 million equity investment. The initial research term is four years, and both parties agreed to dedicate the research personnel provided in the research plan with Biogen Idec increasing funding for research personnel in 2007. Biogen Idec has the option to extend the research term for up to two additional one-year periods upon payment of an additional technology access fee and a commitment to provide research funding. Biogen Idec agreed to bear all costs related to this program for all targets through at least the completion of Phase 1 clinical trials, after which we have the right to participate in the co-development and co-promotion of product candidates for up to two targets.

We granted Biogen Idec a worldwide non-exclusive license to our intellectual property relating to Tethering® with respect to specific collaboration targets and an exclusive license to our portion of the collaboration intellectual property for the commercialization of small molecule compounds that have a specified activity against collaboration kinases arising from the collaboration. Biogen Idec is required to pay up to \$60.5 million in pre-commercialization milestones per target as well as royalty payments depending on product sales. Royalty payments may be increased if we exercise our option on co-development and co-promotion rights. Royalty rates payable to us will be reduced if Biogen Idec is required to license additional intellectual property related to Tethering® from one or more third parties in order to commercialize a collaboration product. Rights to collaboration products revert to us with a reverse royalty to Biogen Idec if Biogen Idec fails to use commercially reasonable and diligent efforts during development and commercialization of co-funded products. If we do not exercise our co-funding option for a product directed at a target selected for further collaborative work, then Biogen Idec may pursue such target on its own. We also have a non-exclusive license, with the right to obtain an exclusive license, from Biogen Idec under joint collaboration intellectual property to develop and commercialize products against other kinase targets. We will owe royalty payments to Biogen Idec for sales of any such products. Royalty obligations under the agreement continue on a country-by-country and product-by-product basis until the later of the date on which no valid patent claim relating to a product exists or 10 years from the date of first sale of the product.

Our agreement with Biogen Idec is scheduled to continue for so long as a product arising from the collaboration is the subject of an active development project or for so long as there is an obligation to pay royalties under the agreement. The agreement may be terminated earlier by Biogen Idec without cause at any time before the second anniversary of the agreement upon six months' written notice or immediately upon written notice and payment of a termination fee. Biogen Idec may also terminate the agreement without cause upon 90 days' written notice. Either party may also terminate the agreement for the other party's uncured breach or bankruptcy. If Biogen Idec terminates the agreement early without cause or we

terminate due to Biogen Idec's breach or bankruptcy, all co-funded products not approved for sale prior to termination will revert to us, and we will receive a reduction in the royalties we owe to Biogen Idec. If Biogen Idec terminates the agreement early due to our breach or bankruptcy, Biogen Idec will receive a reduction in the royalties it owes to us. Many of the parties' other product rights are not substantially affected by early termination.

Johnson & Johnson PRD—Research, Development and Commercialization Collaboration

In May 2002, we entered into a collaboration agreement with Johnson & Johnson PRD to discover, develop and commercialize small molecule inhibitors of Cathepsin S, an enzyme that is important in regulating an inflammatory response. During the period of the research term plus two years, we and Johnson & Johnson PRD agreed to work together exclusively to develop pharmaceutical compounds against Cathepsin S. Johnson & Johnson PRD retains the sole right to determine whether a product candidate enters development. Johnson & Johnson PRD holds worldwide rights to commercialize any drugs resulting from this program.

The agreement provides for payment by Johnson & Johnson PRD to us of a technology access fee and research funding. To date, we have received payments totaling \$6.3 million under this collaboration. The initial research term was two years, and Johnson & Johnson PRD had the option to extend the research term for up to two additional one-year periods with the same level of research funding. Johnson & Johnson PRD exercised its first option to extend the research term through May 2005, and in December 2004, Johnson & Johnson PRD extended the research term further to December 31, 2005. Johnson & Johnson PRD did not extend the research term beyond December 31, 2005.

We granted Johnson & Johnson PRD a worldwide non-exclusive license to our intellectual property relating to Tethering® on Cathepsin S and an exclusive license under the collaboration intellectual property for the commercialization of small molecule products arising from the collaboration. Patents and patent applications arising from the collaboration are owned by our company. Johnson & Johnson PRD is required to pay research and development milestones of up to \$24.5 million well as royalty payments depending on product sales. Royalty rates payable to us may be reduced if Johnson & Johnson PRD is required to license additional intellectual property related to Tethering® from one or more third parties in order to commercialize a collaboration product. Royalty obligations under the agreement continue on a country-by-country and product-by-product basis until the later of the date on which no valid patent claim relating to a product exists or 10 years from the date of first sale of the product.

Although the research term of the collaboration ended in December 2005, our agreement with Johnson & Johnson PRD will continue for so long as a product arising from the collaboration is the subject of an active development project or for so long as there is an obligation to pay royalties under the agreement. We believe Johnson & Johnson PRD is actively pursuing compounds derived from this collaboration. Johnson & Johnson PRD may terminate the agreement earlier without cause after the end of the research term and upon six months' written notice, and either party may terminate the agreement for the other party's uncured breach or bankruptcy. If we terminate the agreement due to Johnson & Johnson PRD's breach or bankruptcy, Johnson & Johnson PRD

would grant us certain exclusive licenses and transfer its regulatory filings to us, and we will be obligated to pay modest royalties to Johnson & Johnson PRD in return.

Merck—BACE Research, Development and Commercialization Collaboration

In February 2003, we entered into a license and collaboration agreement with Merck to discover, develop and commercialize small molecule inhibitors of BACE, or beta secretase, an enzyme that is believed to be important for the progression of Alzheimer's disease. During the period of the research term plus one year, we and Merck agreed to work together exclusively to develop a pharmaceutical

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compound against the collaboration target, with the exception that Merck may acquire from a third party a compound that satisfies development candidate criteria specified in the agreement. Merck holds worldwide rights to commercialize any drugs resulting from this collaboration.

The agreement provides for payment by Merck to us of a technology access fee and research funding. To date, we have received payments totaling \$18.0 million under this collaboration. The initial research term was three years and both parties agreed to dedicate the resource funding provided in the research plan. Merck elected not to exercise its option to extend the research term for an additional one-year period, and the research term of this collaboration ended in February 2006. In June 2006, we received a \$4.25 million payment from Merck for meeting certain preclinical milestones related to BACE.

We granted Merck a worldwide, non-exclusive license to our intellectual property relating to Tethering® on BACE and an exclusive license to a composition of matter patent and future intellectual property relating to BACE. Merck is required to pay research and development milestones of up to \$90.3 million as well as royalty payments depending on product sales. Royalty rates payable to us may be reduced if Merck is required to license additional intellectual property from one or more third parties in order to commercialize a collaboration product or if a third party markets a version of the collaboration product. Royalty obligations under the agreement continue on a country-by-country and product-by-product basis until the later of the date on which no valid patent claim relating to a product exists or 12 years from the date of first sale of the product. We retain the right to develop and commercialize non-pharmaceutical products containing compounds arising from the collaboration. We would owe Merck a royalty based on sales of any such products.

Our agreement with Merck is scheduled to continue for so long as a product arising from the collaboration is the subject of an active development project or for so long as there is an obligation to pay royalties under the agreement. We believe Merck is actively pursuing compounds derived from this collaboration. The agreement may be terminated by either party for the other party's uncured breach or bankruptcy. The agreement may be terminated by Merck at any time upon three months' notice to us.

Merck—Anti-viral License and Research Collaboration

In July 2004, we entered into a license and collaborative research agreement with Merck that allows Merck to discover and develop small molecule drugs against an enzyme target for treating viral infections. During the period from the beginning of the research term until the time that Merck ceases activities against the enzyme target, we agreed not to work with any third party on compounds that inhibit the enzyme target. Merck holds worldwide rights to commercialize any drugs resulting from this collaboration.

The agreement provides for a payment by Merck to us of an upfront technology access fee and annual license fees. To date, we have received \$3.1 million under this collaboration. The initial research term is three years and may be extended for one year upon mutual agreement of the parties. In July 2006, we received the annual license fee of \$150,000 to cover the period from July 2006 through July 2007.

We assigned to Merck small molecule compounds related to the viral target and our interest in research program patents and to compounds that act on the target through our inhibition mode. Merck owns all intellectual property generated in the course of performing the research except for improvements related to Tethering®, which we own. Merck is required to pay pre-commercialization milestones of up to \$22.1 million as well as royalty payments based on product sales. Royalty rates payable to us may be reduced if Merck is required to license additional intellectual property from one or more third parties in order to commercialize a collaboration product. Merck may also reduce its royalty payments to us if the product is not covered by a patent or if a third party markets a competitive product. Royalty obligations under the agreement continue on a country-by-country and product-by-product basis until the later of the date on which no valid patent claim relating to a product exists or 12 years from the date of first sale of the product.

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Our agreement with Merck is scheduled to continue for so long as a product arising from the collaboration is the subject of an active development project or for so long as there is an obligation to pay royalties under the agreement. Either party may terminate the agreement for the other party's uncured breach or bankruptcy. The agreement may be terminated by Merck at any time upon three months' notice to us.

Competition

We compete primarily in the segments of the biopharmaceutical markets that address cancer and other unmet medical needs, which are highly competitive. We face significant competition from many pharmaceutical, biopharmaceutical and biotechnology companies that are researching and selling products designed to address cancer and other unmet medical needs. Many of our competitors have significantly greater financial, manufacturing, marketing and drug development resources than we do. Large pharmaceutical companies in particular have extensive experience in clinical testing and in obtaining regulatory approvals for drugs. These companies also have significantly greater research capabilities than we do. In addition, many universities and private and public research institutes are active in cancer research, some of which are in direct competition with us.

Our product candidates will compete with a number of cancer therapeutics that are currently marketed or in development that also target proliferating cells but at different points of the cell cycle or with a different mechanism of action. These drugs include irinotecan, doxorubicin, taxanes and other cell-cycle inhibitors. To compete effectively with these agents, our product candidates will need to demonstrate advantages that lead to improved clinical efficacy as either a single agent or in combination settings. We believe there are currently over 40 cell-cycle inhibitors undergoing clinical trials worldwide.

SNS-595 is a novel cell-cycle inhibitor that targets DNA repair, causing double strand DNA breaks in replication (S-phase) and inducing G2 arrest followed rapidly by apoptosis. SNS-595 is currently being tested in the clinic in acute leukemias, ovarian cancer and small cell lung cancer. Current competitors to SNS-595 include Genzyme's clofarabine, MGI Pharma's decitabine and Vion's cloretazine, all of which could change the treatment paradigm

of acute leukemia. Each of these compounds are further along in clinical development than is SNS-595. Additionally, Pharmion, Poniard and Vion (Clotretazine®) have compounds in the clinic in small cell lung cancer, and liposomal doxorubicin and topotecan are current standards of care in 2nd line platinum resistant ovarian cancer patients. Furthermore, Telik is testing Telicyta as an add-on to liposomal doxorubicin in a randomized Phase 3 clinical trial, and Novartis has initiated a head-to-head Phase 3 clinical trial in platinum refractory patients. Comparing its compound patupilone against liposomal doxorubicin.

SNS-032 is a targeted inhibitor of certain CDKs, including CDK2, CDK7 and CDK9. We believe that several companies, including AstraZeneca, Cyclacel Pharmaceuticals, Pfizer, Roche, Schering AG and others, are conducting clinical trials with CDK inhibitors and others are developing other compounds that may compete with SNS-032. We are not aware of any CDK inhibitors that are currently being marketed.

We are not aware of any marketed Aurora kinase inhibitors to treat cancer. However, Merck and Vertex are co-developing an Aurora kinase inhibitor and Cyclacel Pharmaceuticals, AstraZeneca, Astex Therapeutics, Millennium Pharmaceuticals and Rigel Pharmaceuticals in conjunction with Serono/Merck, and others are also developing Aurora kinase inhibitors. Several other companies have Aurora kinase programs for which they are close to filing an IND. Other molecules that may compete with SNS-314 may include other naturally occurring cell-cycle inhibitor drugs.

We believe that our Raf kinase inhibitor would compete with Nexavar® developed jointly by Bayer AG and Onyx Pharmaceuticals, which received FDA approval in December 2005, and several compounds being developed by Pfizer. Likewise, Novartis and Plexxicon initiated a Phase 1 clinical trials with their Raf kinase inhibitors in 2006 and Exelixis has filed an IND for its Raf inhibitor and will likely start enrolling patients in clinical trials in 2007.

We also compete with other companies that may be pursuing drug discovery using other technologies, including fragment-based technologies.

We believe that our ability to successfully compete will depend on, among other things:

- our ability to develop novel compounds with attractive pharmaceutical properties free of third party patents and to secure and protect intellectual property rights based on our innovations;
- the efficacy, safety and reliability of our drug candidates;
- the speed at which we develop our drug candidates;
- our ability to design and successfully complete appropriate clinical trials;
- our ability to maintain a good relationship with regulatory authorities;
- the timing and scope of regulatory approvals;
- the success of our collaborations;
- our ability to manufacture and sell commercial quantities of future products to the market; and
- acceptance of future products by physicians and other healthcare providers.

Intellectual Property

We patent the technology, inventions and improvements that we consider important to the development of our business. As of December 31, 2006, we owned or had exclusive rights to 166 issued U.S. and foreign patents and 181 pending U.S. and foreign patent applications. These issued patents expire between June 6, 2015 and June 5, 2023. We have an exclusive license to 44 issued patents that cover SNS-595 compositions of matter. The U.S. composition of matter patent is due to expire on October 6, 2015 and most of its foreign counterparts are due to expire on June 6, 2015. We also have 28 pending applications pertaining to SNS-595 life cycle management. In addition, we have obtained from BMS exclusive rights for SNS-032 and certain other related compounds against CDK-1, -2, -4, -7 and -9. The exclusive rights for SNS-032 primarily derive from four issued U.S. patents, their foreign counterparts, and other patents and applications that claim priority to these four issued U.S. patents. The U.S. composition of matter patent covering SNS-032 is due to expire on October 21, 2018 and most of its foreign counterparts are due to expire on December 7, 2020. In addition, there are four pending Sunesis-filed applications relating to SNS-032 life-cycle management. There are three pending U.S. and two pending foreign applications in our Aurora kinase program and one pending U.S. and one pending foreign application in our Raf kinase program which relate to composition of matter, formulations, and methods of use in oncology and other kinase-mediated diseases. We intend to seek patent term restoration, orphan drug status or data exclusivity in the U.S. and their equivalents in other relevant jurisdictions to the maximum extent that the laws will permit at such time.

We have twenty-five issued patents, which will expire between 2018 and 2022, and 46 pending applications that relate to Tethering®. We also have two pending applications relating to other kinases. We also co-own with, and have exclusively licensed to, Merck 14 pending U.S. applications and 79 pending foreign applications relating to BACE inhibitor compositions of matter. The remaining patents and applications relate to other aspects of our technology or other drug discovery programs that we are no longer actively pursuing.

Our ability to build and maintain our proprietary position for our technology and drug candidates will depend on our success in obtaining effective claims and enforcing those claims once granted. The patent positions of biopharmaceutical companies like ours are generally uncertain and involve complex legal and factual questions for which important legal principles remain unresolved. No consistent policy regarding

the breadth of patent claims has emerged to date in the United States. The patent situation outside the United States is even more uncertain. We do not know whether any of our patent applications or those patent applications that we license will result in the issuance of any patents. The patents we own or license and those that may issue in the future may be challenged, invalidated or circumvented, and the rights granted under any issued patents may not provide us with proprietary protection or competitive advantages.

We may not be able to develop patentable products or be able to obtain patents from pending patent applications. Even if patents are issued, they may not be sufficient to protect the technology and drug candidates owned by or licensed to us. These current patents and patents that may issue in the future may be challenged, invalidated, infringed or circumvented, and the rights granted in those patents may not provide proprietary protection or competitive advantage to

us. Patent applications filed before November 29, 2000 in the United States are maintained in secrecy until patents issue. Later filed U.S. applications and patent applications in most foreign countries generally are not published until at least 18 months after they are filed. Scientific and patent publication often occurs long after the date of the scientific discoveries disclosed in those publications. Accordingly, we cannot be certain that we were the first to invent the subject matter covered by any patent application or that we were the first to file a patent application for any inventions.

Our commercial success depends on our ability to operate without infringing patents and proprietary rights of third parties. We cannot determine with certainty whether patents or patent applications of other parties may materially affect our ability to conduct our business. The existence of third party patent applications and patents could significantly reduce the coverage of patents owned by or licensed to us and limit our ability to obtain meaningful patent protection. If patents containing competitive or conflicting claims are issued to third parties and these claims are ultimately determined to be valid, we may be enjoined from pursuing research, development or commercialization of products, or be required to obtain licenses to these patents or to develop or obtain alternative technology.

We may need to commence litigation to enforce any patents issued to us or to determine the scope and validity of third party proprietary rights. Litigation would result in substantial costs, even if the eventual outcome is favorable to us. An adverse outcome in litigation could subject us to significant liabilities to third parties and require us to seek licenses of the disputed rights from third parties or to cease using the technology if such licenses are unavailable.

We also rely on trade secrets to protect our technology, especially where we do not believe patent protection is appropriate or obtainable. However, trade secrets are difficult to protect.

We seek to protect our proprietary information by requiring our employees, consultants, contractors and other advisers to execute nondisclosure and assignment of invention agreements upon commencement of their employment or engagement. Agreements with our employees also prevent them from bringing the proprietary rights of third parties to us. We also require confidentiality or material transfer agreements from third parties that receive our confidential data or materials. There can be no assurance that these agreements will provide meaningful protection, that these agreements will not be breached, that we will have an adequate remedy for any such breach, or that our trade secrets will not otherwise become known or independently developed by a third party.

Government Regulation

The Food and Drug Administration, or FDA, and comparable regulatory agencies in state and local jurisdictions and in foreign countries impose substantial requirements upon the clinical development, manufacture, marketing and distribution of drugs. These agencies and other federal, state and local entities regulate research and development activities and the testing, manufacture, quality control, safety,

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efficacy, labeling, storage, record keeping, approval, advertising and promotion of our drug candidates and drugs.

U.S. Government Regulation

In the United States, the FDA regulates drugs under the Federal Food, Drug, and Cosmetic Act, or FDCA, and implementing regulations. The process required by the FDA before our drug candidates may be marketed in the United States generally involves the following:

- completion of extensive preclinical laboratory tests, preclinical animal studies and formulation studies, all performed in accordance with FDA's good laboratory practices, or GLP, regulations;
- submission to FDA of an IND application which must become effective before clinical trials may begin;
- performance of adequate and well-controlled clinical trials to establish the safety and efficacy of the product candidate for each proposed indication;
- submission of a new drug application, or NDA, to the FDA;
- satisfactory completion of a FDA pre-approval inspection of the manufacturing facilities at which the product candidate is produced to assess compliance with current GMP, or cGMP, regulations; and
- FDA review and approval of the NDA prior to any commercial marketing, sale or shipment of the drug.

The testing and approval process requires substantial time, effort and financial resources, and we cannot be certain that any approvals for our drug candidates will be granted on a timely basis, if at all.

Preclinical tests include laboratory evaluation of product chemistry, formulation and stability, as well as studies to evaluate toxicity in animals. The results of preclinical tests, together with manufacturing information and analytical data, are submitted as part of an IND application to the FDA. The IND automatically becomes effective 30 days after receipt by the FDA, unless the FDA, within the 30-day time period, raises concerns or questions about the conduct of the clinical trial, including concerns that human research subjects will be exposed to unreasonable health risks. In such a case, the IND sponsor and the FDA must resolve any outstanding concerns before the clinical trial can begin. Our submission of an IND, or those of our collaboration partners, may not result in FDA authorization to commence a clinical trial. A separate submission to an existing IND must also be made for each successive clinical trial conducted during product development, and FDA must grant permission before each clinical trial can begin. Further, an independent institutional review board, or IRB for each medical center proposing to conduct the clinical trial, must review and approve the plan for any clinical trial before it commences at that center and it must monitor the study until completed. The FDA, the IRB or the sponsor may suspend a clinical trial at any time on various grounds, including a finding that the subjects or patients are being exposed to an unacceptable health risk. Clinical testing also must satisfy extensive Good Clinical Practice, or GCP, requirements and regulations for informed consent.

Clinical Trials

For purposes of NDA submission and approval, clinical trials are typically conducted in the following three sequential phases, which may overlap:

- *Phase 1 clinical trials* are initially conducted in a limited population to test the drug candidate for safety, dose tolerance, absorption, metabolism, distribution and excretion in healthy humans or, on occasion, in patients, such as cancer patients. In some cases, particularly in cancer trials, a sponsor

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may decide to conduct what is referred to as a “Phase 1b” evaluation, which is a second safety-focused Phase 1 clinical trial typically designed to evaluate the impact of the drug candidate in combination with currently approved drugs.

- *Phase 2 clinical trials* are generally conducted in a limited patient population to identify possible adverse effects and safety risks, to determine the efficacy of the drug candidate for specific targeted indications and to determine dose tolerance and optimal dosage. Multiple Phase 2 clinical trials may be conducted by the sponsor to obtain information prior to beginning larger and more expensive Phase 3 clinical trials. In some cases, a sponsor may decide to conduct what is referred to as a “Phase 2b” evaluation, which is a second, confirmatory Phase 2 clinical trial that could, if positive and accepted by the FDA, serve as a pivotal clinical trial in the approval of a drug candidate.
- *Phase 3 clinical trials* are commonly referred to as pivotal trials. When Phase 2 clinical trials demonstrate that a dose range of the drug candidate is effective and has an acceptable safety profile, Phase 3 clinical trials are undertaken in large patient populations to further evaluate dosage, to provide substantial evidence of clinical efficacy and to further test for safety in an expanded and diverse patient population at multiple, geographically dispersed clinical trial sites.

In some cases, the FDA may condition approval of an NDA for a drug candidate on the sponsor’s agreement to conduct additional clinical trials to further assess the drug’s safety and efficacy after NDA approval. Such post-approval trials are typically referred to as Phase 4 clinical trials.

New Drug Application

The results of drug candidate development, preclinical testing and clinical trials are submitted to the FDA as part of an NDA. The NDA also must contain extensive manufacturing information. Once the submission has been accepted for filing, by law the FDA has 180 days to review the application and respond to the applicant. The review process is often significantly extended by FDA requests for additional information or clarification. The FDA may refer the NDA to an advisory committee for review, evaluation and recommendation as to whether the application should be approved. The FDA is not bound by the recommendation of an advisory committee, but it generally follows such recommendations. The FDA may deny approval of an NDA if the applicable regulatory criteria are not satisfied, or it may require additional clinical data or an additional pivotal Phase 3 clinical trial. Even if such data are submitted, the FDA may ultimately decide that the NDA does not satisfy the criteria for approval. Data from clinical trials are not always conclusive and the FDA may interpret data differently than we or our collaboration partners interpret data. Once issued, the FDA may withdraw drug approval if ongoing regulatory requirements are not met or if safety problems occur after the drug reaches the market. In addition, the FDA may require testing, including Phase 4 clinical trials, and surveillance programs to monitor the effect of approved products that have been commercialized, and the FDA has the power to prevent or limit further marketing of a drug based on the results of these post-marketing programs. Drugs may be marketed only for the approved indications and in accordance with the provisions of the approved label. Further, if there are any modifications to the drug, including changes in indications, other labeling changes, or manufacturing processes or facilities, we may be required to submit and obtain FDA approval of a new NDA or NDA supplement, which may require us to develop additional data or conduct additional preclinical studies and clinical trials.

Fast Track Designation

FDA’s fast track program is intended to facilitate the development and to expedite the review of drugs that are intended for the treatment of a serious or life-threatening condition for which there is no effective treatment and which demonstrate the potential to address unmet medical needs for the condition. Under

the fast track program, the sponsor of a new drug candidate may request the FDA to designate the drug candidate for a specific indication as a fast track drug concurrent with or after the filing of the IND for the drug candidate. The FDA must determine if the drug candidate qualifies for fast track designation within 60 days of receipt of the sponsor’s request.

If fast track designation is obtained, the FDA may initiate review of sections of an NDA before the application is complete. This rolling review is available if the applicant provides and the FDA approves a schedule for the submission of the remaining information and the applicant pays applicable user fees. However, the time period specified in the Prescription Drug User Fees Act, which governs the time period goals the FDA has committed to reviewing an application, does not begin until the complete application is submitted. Additionally, the fast track designation may be withdrawn by the FDA if the FDA believes that the designation is no longer supported by data emerging in the clinical trial process.

In some cases, a fast track designated drug candidate may also qualify for one or more of the following programs:

- *Priority Review.* Under FDA policies, a drug candidate is eligible for priority review, or review within a six-month time frame from the time a complete NDA is accepted for filing, if the drug candidate provides a significant improvement compared to marketed drugs in the treatment, diagnosis or prevention of a disease. A fast track designated drug candidate would ordinarily meet the FDA’s criteria for priority review. We do not know whether any of our drug candidates will receive a priority review designation or, if a priority designation is received, whether that review or approval will be faster than conventional FDA procedures, or that the FDA will ultimately grant drug approval.
- *Accelerated Approval.* Under the FDA’s accelerated approval regulations, the FDA is authorized to approve drug candidates that have been studied for their safety and efficacy in treating serious or life-threatening illnesses and that provide meaningful therapeutic benefit to patients over existing treatments based upon either a surrogate endpoint that is reasonably likely to predict clinical benefit or on the basis of an effect on a clinical endpoint other than patient survival. In clinical trials, surrogate endpoints are alternative measurements of the symptoms of a disease or condition that are substituted for measurements of observable clinical symptoms. A drug candidate approved on this basis is subject to rigorous post-marketing compliance requirements, including the completion of Phase 4 or post-approval clinical trials to validate the surrogate endpoint or confirm the effect on the clinical endpoint. Failure to conduct required post-approval studies, or to validate a surrogate endpoint or confirm a clinical benefit during post-marketing studies, will allow the FDA to withdraw the drug from the market on an expedited basis. All promotional materials for drug candidates approved under accelerated regulations are subject to prior review by the FDA.

When appropriate, we and our collaboration partners intend to seek fast track designation, accelerated approval or priority review for our drug candidates. We cannot predict whether any of our drug candidates will obtain a fast track or accelerated approval designation, or the ultimate impact, if any, of the fast track or the accelerated approval process on the timing or likelihood of FDA approval of any of our drug candidates.

Satisfaction of FDA regulations and approval requirements or similar requirements of foreign regulatory agencies typically takes several years, and the actual time required may vary substantially based upon the type, complexity and novelty of the product or disease. Typically, if a drug candidate is intended to

treat a chronic disease, as is the case with some of the drug candidates we are developing, safety and efficacy data must be gathered over an extended period of time. Government regulation may delay or prevent marketing of drug candidates for a considerable period of time and impose costly procedures upon our activities. The FDA or any other regulatory agency may not grant approvals for new indications for our drug candidates on a timely basis, or at all. Even if a drug candidate receives regulatory approval, the

approval may be significantly limited to specific disease states, patient populations and dosages. Further, even after regulatory approval is obtained, later discovery of previously unknown problems with a drug may result in restrictions on the drug or even complete withdrawal of the drug from the market. Delays in obtaining, or failures to obtain, regulatory approvals for any of our drug candidates would harm our business. In addition, we cannot predict what adverse governmental regulations may arise from future United States or foreign governmental action.

Other Regulatory Requirements

Any drugs manufactured or distributed by us or our collaboration partners pursuant to FDA approvals are subject to continuing regulation by the FDA, including recordkeeping requirements and reporting of adverse experiences associated with the drug. Drug manufacturers and their subcontractors are required to register with the FDA and certain state agencies, and are subject to periodic unannounced inspections by the FDA and certain state agencies for compliance with ongoing regulatory requirements, including cGMPs, which impose certain procedural and documentation requirements upon us and our third-party manufacturers. Failure to comply with the statutory and regulatory requirements can subject a manufacturer to possible legal or regulatory action, such as warning letters, suspension of manufacturing, seizure of product, injunctive action or possible civil penalties. We cannot be certain that we or our present or future third-party manufacturers or suppliers will be able to comply with the cGMP regulations and other ongoing FDA regulatory requirements. If our present or future third-party manufacturers or suppliers are not able to comply with these requirements, the FDA may halt our clinical trials, require us to recall a drug from distribution, or withdraw approval of the NDA for that drug.

The FDA closely regulates the post-approval marketing and promotion of drugs, including standards and regulations for direct-to-consumer advertising, off-label promotion, industry-sponsored scientific and educational activities and promotional activities involving the Internet. A company can make only those claims relating to safety and efficacy that are approved by the FDA. Failure to comply with these requirements can result in adverse publicity, warning letters, corrective advertising and potential civil and criminal penalties. Physicians may prescribe legally available drugs for uses that are not described in the drug's labeling and that differ from those tested by us and approved by the FDA. Such off-label uses are common across medical specialties, including cancer therapy. Physicians may believe that such off-label uses are the best treatment for many patients in varied circumstances. The FDA does not regulate the behavior of physicians in their choice of treatments. The FDA does, however, impose stringent restrictions on manufacturers' communications regarding off-label use.

Foreign Regulation

In addition to regulations in the United States, we are subject to foreign regulations governing clinical trials and commercial sales and distribution of our future products. We are currently conducting clinical trials in Canada and plan to initiate clinical trials in Europe in the second half of 2007. Whether or not we obtain FDA approval for a product, we must obtain approval of a product by the comparable regulatory authorities of foreign countries before we can commence clinical trials or marketing of the product in those countries. The approval process varies from country to country, and the time may be longer or shorter than that required for FDA approval. The requirements governing the conduct of clinical trials, product licensing, pricing and reimbursement vary greatly from country to country.

Under the Canadian regulatory system, Health Canada is the regulatory body that governs the sale of drugs for the purposes of use in clinical trials. Accordingly, any company that wishes to conduct a clinical trial in Canada must submit a clinical trial application to Health Canada. Health Canada reviews the application and notifies the company within 30 days if the application is found to be deficient. If the application is deemed acceptable, Health Canada will issue a letter to the company within the 30-day review period which means the company may proceed with its clinical trial(s).

Under European Union regulatory systems, marketing authorizations may be submitted either under a centralized or mutual recognition procedure. The centralized procedure provides for the grant of a single marketing authorization that is valid for all European Union member states. The mutual recognition procedure provides for mutual recognition of national approval decisions. Under this procedure, the holder of a national marketing authorization may submit an application to the remaining member states. Within 90 days of receiving the applications and assessment report, each member state must decide whether to recognize approval.

In addition to regulations in Europe, Canada and the United States, we will be subject to a variety of other foreign regulations governing clinical trials and commercial distribution of our future products. Our ability to sell drugs will also depend on the availability of reimbursement from government and private practice insurance companies.

Employees

As of December 31, 2006, our workforce consisted of 138 full-time employees, 46 of whom hold Ph.D. or M.D. degrees, and 33 of whom hold other advanced degrees. Of our total workforce, 111 are engaged in research and development and 27 are engaged in business development, finance, legal, human resources, facilities and information technology administration and general management. We have no collective bargaining agreements with our employees, and we have not experienced any work stoppages. We believe that our relations with our employees are good.

ITEM 1A. RISK FACTORS

Investing in our common stock involves a high degree of risk. You should carefully consider the risks and uncertainties described below and all information contained in this report before you decide to purchase our common stock. If any of the possible adverse events described below actually occurs, we may be unable to conduct our business as currently planned and our financial condition and operating results could be harmed. In addition, the trading price of our common stock could decline due to the occurrence of any of these risks, and you may lose all or part of your investment. Please see "Special Note Regarding Forward-Looking Statements."

Risks Related to Our Business

We have incurred losses since inception and anticipate that we will continue to incur losses for the foreseeable future. We may not ever achieve or sustain profitability.

We are a clinical-stage biopharmaceutical company with a limited operating history. We are not profitable and have incurred losses in each year since our inception in 1998. We do not currently have any products that have been approved for marketing, and we continue to incur research and development, and general and administrative expenses related to our operations. Our net loss for 2006, 2005 and 2004 was \$31.2 million, \$27.5 million (excluding a preferred stock dividend of \$88.1 million) and \$20.5 million, respectively. As of December 31, 2006, we had an accumulated deficit of \$240.2 million, including an \$88.1 million deemed dividend related to our IPO in September 2005. We expect to continue to incur losses for the foreseeable future, and we expect these losses to increase significantly, especially upon commencing Phase 3 clinical trials, as we continue our research activities and conduct development of, and seek regulatory approvals for, our product candidates, and commercialize any approved drugs. Our losses, among other things, have caused and will continue to cause our stockholders' equity and working capital to decrease. To date, we have derived all of our revenue from collaboration agreements and, to a lesser extent, grants and fellowships. We do not anticipate that we will generate revenue from the sale of products for the foreseeable future. If our product candidates fail in clinical trials or do not gain regulatory approval, or if our future products do not achieve market acceptance, we may never become profitable.

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Even if we achieve profitability in the future, we may not be able to sustain profitability in subsequent periods.

We will require substantial additional funding, which may not be available to us on acceptable terms, or at all.

We are advancing multiple product candidates through discovery and development. We will need to raise substantial additional capital to continue our discovery, development and commercialization activities. We plan to retain the development and commercialization rights to some of our novel cancer therapeutics at least until we have completed a Phase 2 clinical trial to maximize our economic upside, which will require substantial expenditures by us. In 2007, we intend to enter into a strategic partnership for one of our product candidates wherein we would extend the geographic reach of the product candidate while retaining significant U.S. ownership.

We will need to raise substantial additional capital to:

- fund clinical trials and seek regulatory approvals;
- pursue the development of additional product candidates;
- expand our research and development activities;
- build or access manufacturing and commercialization capabilities;
- implement additional internal systems and infrastructure;
- maintain, defend and expand the scope of our intellectual property portfolio; and
- hire additional management and scientific personnel.

Our future funding requirements will depend on many factors, including but not limited to:

- the rate of progress and cost of our clinical trials, preclinical studies and other discovery and research and development activities;
- the costs associated with establishing manufacturing and commercialization capabilities;
- the costs of acquiring or investing in businesses, product candidates and technologies;
- the costs of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights;
- the costs and timing of seeking and obtaining FDA and other regulatory approvals;
- the effect of competing technological and market developments; and
- the economic and other terms and timing of any collaboration, licensing or other arrangements into which we may enter.

Until we can generate a sufficient amount of product revenue to finance our cash requirements, which we may never do, we expect to finance future cash needs primarily through public or private equity offerings, debt financings or strategic collaborations. We do not know whether additional funding will be available on acceptable terms, or at all. If we are not able to secure additional funding when needed, we may have to delay, reduce the scope of or eliminate one or more of our clinical trials or research and development programs. In addition, we plan to partner one or more of our product candidate programs at an earlier stage of development, which would lower the economic value of such program or programs to our company.

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There is a high risk that our drug discovery and development activities could be halted significantly or delayed for various reasons.

Most of our product candidates are in the early stages of drug discovery or development and are prone to the risks of failure inherent in drug development. As of the date of this report, only two of our product candidates, SNS-595 and SNS-032, have been tested in humans. We and our collaboration partners will need to conduct significant additional preclinical studies and clinical trials before we or our collaboration partners can demonstrate that our product candidates are safe and effective to the satisfaction of the FDA and other regulatory authorities. In our industry, it is unlikely that the limited number of compounds that we have identified as potential product candidates will actually lead to successful product development efforts. Failure can occur at any stage of the process, and successful preclinical studies and early clinical trials do not ensure that later clinical trials will be successful. Product candidates in later stage trials may fail to show desired efficacy and safety traits despite having progressed through initial clinical trials. A number of companies in the pharmaceutical industry have suffered significant setbacks in advanced clinical trials, even after obtaining promising results in earlier trials.

We do not know whether our ongoing Phase 1 and Phase 2 clinical trials with SNS-595, our ongoing and planned Phase 1 clinical trials with SNS-032, our planned Phase 1 clinical trial with SNS-314, or any other future clinical trials with any of our product candidates will be completed on schedule, or at all, or whether our ongoing or planned Phase 1 and Phase 2 clinical trials will begin on time. The commencement of our planned clinical trials could be substantially delayed or prevented by several factors, including:

- limited number of, and competition for, suitable patients with particular types of cancer for enrollment in clinical trials;
- delays or failures in obtaining regulatory approval to commence a clinical trial;
- delays or failures in obtaining sufficient clinical materials;
- delays or failures in reaching agreement on acceptable clinical trial agreement terms or clinical trial protocols with prospective sites; or
- delays or failures in obtaining institutional review board approval to conduct a clinical trial at a prospective site.

The completion of our clinical trials could also be substantially delayed or prevented by several factors, including:

- slower than expected rates of patient recruitment and enrollment;
- failure of patients to complete the clinical trial;
- unforeseen safety issues;
- lack of efficacy during clinical trials;
- inability or unwillingness of patients or medical investigators to follow our clinical trial protocols; and
- inability to monitor patients adequately during or after treatment.

For example, due to potential complications from treatment in our planned Phase 1 clinical trial of SNS-032 in B-cell lymphoid malignancies, we will need to provide patients enrolling in this clinical trial with in-patient hospital care. We believe that this may result in difficulty in recruiting patients and increased costs in performing the clinical trial. Additionally, our clinical trials may be suspended or terminated at any time by the FDA, other regulatory authorities, our company or, in some cases, our

collaboration partners. Any failure or significant delay in completing clinical trials for our product candidates could harm our financial results and the commercial prospects for our product candidates.

Our clinical trials for our lead product candidates, SNS-595, SNS-032 and SNS-314, may not demonstrate safety or efficacy or lead to regulatory approval.

Our lead product candidates, SNS-595, SNS-032 and SNS-314, are small-molecule therapeutics being developed for the treatment of certain types of cancer. Many cancer drugs promote cancer cell death by inhibiting cell proliferation, and commonly have a narrow dose range between efficacy and toxicity, commonly known as a “therapeutic window.” Based on the results of our Phase 1 clinical trials, we may select a dose for use in future clinical trials that may prove to be ineffective in treating cancer. If our clinical trials result in unacceptable toxicity or lack of efficacy, we may have to terminate further clinical trials for SNS-595, SNS-032 and/or SNS-314. Even if we are able to find a proper dose that balances the toxicity and efficacy of one or more of our product candidates, we will be required to conduct extensive additional clinical trials before we are able to seek the regulatory approvals needed to market them. If clinical trials of SNS-595, SNS-032 and/or SNS-314 are halted, or if they do not show that these product candidates are safe and effective, our future growth would be limited and we may not have any other product candidates to develop. Furthermore, our current development strategy for each of SNS-595, SNS-032 and SNS-314 is to test the efficacy and toxicity of each product candidate as a single agent. We may later determine that one or more of these product candidates is more efficacious and/or less toxic in combination with another approved cancer drug. Likewise, each of our product candidates may only receive FDA and foreign approvals, if at all, in combination with another cancer drug.

In addition to the risks described above, we are aware of risks that are specific to SNS-032. In previous Phase 1 clinical trials of SNS-032, significant safety risks were observed in patients who were administered SNS-032 on either a one-hour or a 24-hour infusion once every three weeks. For example, increases in certain phases of the cardiac cycle, known as the QT interval, or the corrected QT interval, or QTc, on the electrocardiograms of patients were observed in patients receiving the 24-hour infusion regimen. Increased QT intervals may be associated with increased risk for cardiac rhythm abnormalities, some of which can be serious, life-threatening events. In addition, pronounced, rapidly reversible decreases in white blood cells were observed following infusion under the one-hour infusion regimen, most likely associated with higher peak drug levels in this regimen. Further, some patients also experienced reversible liver toxicity, which limited the amount of drug that could be administered to those patients. Two of these planned clinical trials were discontinued prior to completion and prior to determination of a maximum tolerated dose. Both of these trials were discontinued by the former sponsor, BMS, because of a change in priorities within BMS’ portfolio. We will not receive regulatory approval for SNS-032 unless we are able to deliver therapeutically active doses of SNS-032 while keeping toxicities at acceptable levels. In our existing Phase 1 clinical trial, we are delivering the drug on a daily basis in a one-hour infusion for five consecutive days. There is a significant risk that this dose and regimen may not allow us to achieve efficacious exposure in the absence of dose-limiting toxicity, and thus SNS-032 may not advance as a single agent therapeutic.

In our Phase 1 clinical trial of SNS-032 in B-cell lymphoid malignancies, we are aware that SNS-032 has the potential to kill a large number of cancer cells rapidly and all at once and the contents of those cells may be released into a patient’s bloodstream. This may result in a higher risk of a severe complication called tumor lysis syndrome. If tumor lysis syndrome occurs, some chemicals in a patient’s blood, such as potassium, uric acid and phosphate levels will rise, whereas some others like calcium may decline. Tumor lysis syndrome, if severe enough, may result in kidney failure and without treatment, can be life-threatening. We are aware that this severe complication has a higher risk of occurring early in the course of treatment and we are taking measures, which may not be effective, to prevent, monitor and treat this complication should it occur.

In addition, in clinical trials to date SNS-032 has demonstrated variable pharmacokinetics, or PK, which is the measure of the concentration of drug in the bloodstream over time. The PK variability results in differences in drug exposure between patients, and in some cases in the same patient, who are administered the same dose of SNS-032. Dose levels in Phase 2 clinical trials will be selected primarily based on safety criteria. Because of the observed PK variability between and among patients, we believe that there is a risk that some patients may receive sub-therapeutic exposure, limiting the opportunity to show activity and efficacy for SNS-032. As with other product candidates in the biotechnology industry at this stage of development, even if we are able to find adequate doses and schedules from our planned Phase 2 clinical trials, we will be required to conduct extensive additional clinical trials before we are able to seek regulatory approval to market SNS-032.

If we fail to maintain our existing, or enter into new, strategic collaborations, we may have to reduce or delay our product candidate development or increase our expenditures.

Our business model is based in part upon entering into strategic collaborations for discovery and/or development of some of our product candidates. In particular, we are substantially dependent on our strategic collaboration with Biogen Idec to discover, develop and commercialize small molecule inhibitors of Raf kinase and up to five additional targets. The agreement may be terminated by Biogen Idec without cause at any time upon 90 days' written notice. If we are not able to maintain this collaboration with Biogen Idec or our other existing collaborations, or establish and maintain additional strategic collaborations of similar scope:

- the development of our current or future product candidates may be terminated or delayed;
- our cash expenditures related to development of our current or future product candidates would increase significantly;
- we may be required to hire additional employees or otherwise develop expertise, such as sales and marketing expertise, for which we have not budgeted;
- we will bear all of the risk related to the development of each of our current and future product candidates; and
- we may be unable to meet demand for any future products that we may develop.

In that event, we would likely be required to limit the size or scope of one or more of our programs.

The results of preclinical studies and clinical trials may not satisfy the requirements of the FDA or other regulatory agencies.

Prior to receiving approval to commercialize any of our product candidates in the United States or abroad, we and our collaboration partners must demonstrate with substantial evidence from well-controlled clinical trials, and to the satisfaction of the FDA and other regulatory authorities abroad, that such product candidates are safe and effective for their intended uses. The results from preclinical studies and clinical trials can be interpreted in different ways. Even if we and our collaboration partners believe the preclinical or clinical data for our product candidates are promising, such data may not be sufficient to support approval by the FDA and other regulatory authorities. Administering any of our product candidates to humans may produce undesirable side effects, which could interrupt, delay or halt clinical trials of our product candidates and result in the FDA or other regulatory authorities denying approval of our product candidates for any or all targeted indications.

Our approach to developing cancer therapeutics by inhibiting cyclin-dependent kinases, Aurora kinases and Raf kinases has not been clinically validated and may not be successful.

We have programs to develop small molecule inhibitors of CDK, Aurora and Raf kinases for the treatment of cancer. SNS-032 is a CDK inhibitor, and SNS-314 is an Aurora kinase inhibitor. The therapeutic benefit of inhibiting CDK, Aurora or Raf kinases in the treatment of human cancer has not been established definitively. Although a competitive kinase inhibitor, Nexavar®, has recently been approved and is commencing commercial use, this compound inhibits Raf and other kinases and its non-Raf kinase activities may be responsible for its efficacy. In addition, there are conflicting scientific reports regarding the reliance or necessity of CDK2 in the cell-cycle. Although several other companies have CDK and Aurora kinase programs, we are not aware of any candidates that have demonstrated therapeutic benefit in clinical testing. If CDK, Aurora or Raf kinase inhibition is not an effective treatment of human cancer, SNS-032, SNS-314 and any other drug candidates from these programs may have little or no commercial value.

The failure to enroll patients for clinical trials may cause delays in developing our product candidates.

We may encounter delays if we or our collaboration partners are unable to enroll enough patients to complete clinical trials. Patient enrollment depends on many factors, including, the size of the patient population, the nature of the protocol, the proximity of patients to clinical sites and the eligibility criteria for the trial. Moreover, when one product candidate is evaluated in multiple clinical trials simultaneously, patient enrollment in ongoing trials can be adversely affected by negative results from completed trials. Our product candidates are focused in oncology, which can be a difficult patient population to recruit. Without exception, oncology patients have failed treatment in first and second line treatment before enrolling in a study of an investigational product candidate.

We rely on a third party to manufacture our product candidates, including SNS-595, SNS-032 and SNS-314, and depend on a single supplier for SNS-595 and SNS-032. There is a limited number of manufacturers that are capable of manufacturing the active ingredient of SNS-595.

We do not currently own or operate manufacturing facilities and lack the capability to manufacture any of our product candidates on a clinical or commercial scale. As a result, we rely on third parties to manufacture both the active pharmaceutical ingredients, or API, and drug products for SNS-595, SNS-032 and SNS-314. The APIs are classified as toxic substances, limiting the available manufacturers. We believe that there are at least five contract manufacturers in North America with suitable capabilities for API manufacture, and at least four that can manufacture our drug products. If our third-party manufacturers are unable or unwilling to produce API, we will need to establish contracts with other suppliers. However, establishing a relationship with an alternative supplier would likely delay our ability to produce API for six to nine months, during which time we will rely on current inventory to supply our drug product manufacturing activities. We expect to continue to depend on third-party contract manufacturers for the foreseeable future.

Our product candidates require precise, high quality manufacturing. A contract manufacturer is subject to ongoing periodic unannounced inspection by the FDA and corresponding state agencies to ensure strict compliance with current Good Manufacturing Practice, or cGMP, and other applicable government regulations and corresponding foreign standards. Our contract manufacturer's failure to achieve and maintain high manufacturing standards in compliance with cGMP regulations could result in manufacturing errors resulting in patient injury or death, product recalls or withdrawals, delays or interruptions of production or failures in product testing or delivery, delay or prevention of filing or approval of marketing applications for our products, cost overruns or other problems that could seriously harm our business.

To date, our product candidates have been manufactured in small quantities for preclinical studies and clinical trials. Prior to one of our product candidates being approved for commercial sale, we will need to manufacture that product in larger quantities. Significant scale-up of manufacturing will be accompanied by significant validation studies, which will be reviewed by the FDA prior to approval. If we are unable to successfully increase the manufacturing capacity for a product candidate, the regulatory approval or commercial launch may be delayed or there may be a shortage in commercial supply.

Any performance failure on the part of a contract manufacturer could delay clinical development or regulatory approval of our product candidates or commercialization of our future products, depriving us of potential product revenue and resulting in additional losses. In addition, our dependence on a third party for manufacturing may adversely affect our future profit margins. Our ability to replace an existing manufacturer may be difficult because the number of potential manufacturers is limited and the FDA must approve any replacement manufacturer before it can begin manufacturing our product candidates for commercial sale. Such approval would require new testing and compliance inspections. It may be difficult or impossible for us to identify and engage a replacement manufacturer on acceptable terms in a timely manner, or at all.

We expect to significantly expand our clinical research and development and marketing capabilities, and any difficulties retaining key personnel or managing this growth could disrupt our operations.

We are highly dependent on the principal members of our management and technical staff. We expect to significantly expand our clinical research and development and marketing capabilities by increasing expenditures in these areas, hiring additional employees and expanding the scope of our current operations. Future growth will require us to continue to implement and improve our managerial, operational and financial systems, expand our facilities and continue to retain, recruit and train additional qualified personnel, which may impose a strain on our administrative and operational infrastructure. The competition for qualified personnel in the biopharmaceutical field is intense. We are highly dependent on our continued ability to attract, retain and motivate highly-qualified management, clinical and scientific personnel. Due to our limited resources, we may not be able to effectively manage the expansion of our operations or recruit and train additional qualified personnel. If we are unable to retain key personnel or manage our growth effectively, we may not be able to implement our business plan.

If we are sued for infringing intellectual property rights of third parties, litigation will be costly and time consuming and could prevent us from developing or commercializing our future products.

Our commercial success depends on not infringing the patents and proprietary rights of other parties and not breaching any collaboration or other agreements we have entered into with regard to our technologies and product candidates. Numerous third-party U.S. and foreign issued patents and pending applications exist in the area of kinases, including CDK, Aurora and Raf kinases for which we have research programs. Because patent applications can take several years to issue, there may be pending applications that may result in issued patents that cover our technologies or product candidates. For example, some pending patent applications contain broad claims that could represent freedom to operate limitations for some of our kinase programs should they be issued unchanged. If we wish to use the technology or compound claimed in issued and unexpired patents owned by others, we will need to obtain a license from the owner, enter into litigation to challenge the validity of the patents or incur the risk of litigation in the event that the owner asserts that we infringe its patents.

If a third party asserts that we infringe its patents or other proprietary rights, we could face a number of issues that could seriously harm our competitive position, including:

- infringement and other intellectual property claims, which would be costly and time consuming to litigate, whether or not the claims have merit, and which could delay the regulatory approval process and divert management's attention from our business;
- substantial damages for past infringement, which we may have to pay if a court determines that our product candidates or technologies infringe a competitor's patent or other proprietary rights;
- a court prohibiting us from selling or licensing our technologies or future drugs unless the holder licenses the patent or other proprietary rights to us, which it is not required to do; and
- if a license is available from a third party, we may have to pay substantial royalties or grant cross licenses to our patents or other proprietary rights.

If our competitors develop and market products that are more effective, safer or less expensive than our future products, our commercial opportunities will be negatively impacted.

The life sciences industry is highly competitive, and we face significant competition from many pharmaceutical, biopharmaceutical and biotechnology companies that are researching and marketing products designed to address cancer and other unmet medical needs. We are developing small molecule therapeutics that will compete with other drugs and therapies that currently exist or are being developed. Many of our competitors have significantly greater financial, manufacturing, marketing and drug development resources than we do. Large pharmaceutical companies in particular have extensive experience in clinical testing and in obtaining regulatory approvals for drugs. These companies also have significantly greater research capabilities than we do. In addition, many universities and private and public research institutes are active in cancer, Alzheimer's and inflammation research, some of which are in direct competition with us.

Our product candidates will compete with a number of drugs that are currently marketed or in development that also target proliferating cells. These drugs include marketed products, such as irinotecan, doxorubicin and taxanes, which are generic and widely available, and many other cell-cycle inhibitors that have been shown to be effective anti-cancer agents. To compete effectively with these agents, our product candidates will need to demonstrate advantages that lead to improved clinical efficacy compared to these competitive products. We also compete with other companies that may be pursuing drug discovery using other technologies, including fragment-based technologies.

We believe that our ability to successfully compete will depend on, among other things:

- our ability to develop novel compounds with attractive pharmaceutical properties and to secure and protect intellectual property rights based on our innovations;

- the efficacy, safety and reliability of our product candidates;
- the speed at which we develop our product candidates;
- our ability to design and successfully execute appropriate clinical trials;
- our ability to maintain a good relationship with regulatory authorities;
- the timing and scope of regulatory approvals;
- our ability to manufacture and sell commercial quantities of future products to the market; and
- acceptance of future products by physicians and other healthcare providers.

If our competitors market products that are more effective, safer or less expensive than our future products, if any, or that reach the market sooner than our future products, if any, we may not achieve commercial success. In addition, the biopharmaceutical industry is characterized by rapid technological change. Because our research approach integrates many technologies, it may be difficult for us to stay abreast of the rapid changes in each technology. If we fail to stay at the forefront of technological change, we may be unable to compete effectively. Technological advances or products developed by our competitors may render our technologies or product candidates obsolete.

Our proprietary Tethering® drug discovery approach is experimental and may not discover any therapeutic compounds of commercial value.

We have developed a proprietary drug discovery approach called “Tethering®.” Tethering® is a process whereby a target protein known to be involved in a disease process is engineered to facilitate the binding of small drug fragments. Once a small fragment is identified, the fragment is built out using the target protein’s surface as a template to make a new full-size therapeutic compound. Tethering® is unproven as a drug discovery approach. We have only conducted preclinical studies of product candidates discovered through Tethering®. Our Tethering® drug discovery approach may not identify any therapeutic compounds of commercial value.

We rely on third parties to conduct our clinical trials for SNS-595 and SNS-032 and plan to rely on third parties to conduct our clinical trials for SNS-314. If these third parties do not successfully carry out their contractual duties or meet expected deadlines, we may be unable to obtain regulatory approval for or commercialize SNS-595, SNS-032, SNS-314 or any of our other product candidates.

We do not have the ability to independently conduct clinical trials for SNS-595, SNS-032, SNS-314 or any other product candidate. We rely on third parties, such as contract research organizations, medical institutions, clinical investigators and contract laboratories, to conduct our planned and existing clinical trials in the United States, Canada and Europe of our product candidates for which we do not have a collaboration. If the third parties conducting our clinical trials do not perform their contractual duties or obligations, do not meet expected deadlines or need to be replaced, or if the quality or accuracy of the clinical data they obtain is compromised due to the failure to adhere to our clinical trial protocols or for any other reason, we may need to enter into new arrangements with alternative third parties and our clinical trials may be extended, delayed or terminated or may need to be repeated, and we may not be able to obtain regulatory approval for or commercialize the product candidate being tested in such trials.

The commercial success of our collaborations depends in part on the development and marketing efforts of our collaboration partners, over which we have limited control. If our collaborations are unsuccessful, our potential to develop and commercialize products through our collaborations, and to generate future revenue from the sale of these products, would be significantly reduced.

Our dependence on collaboration arrangements subjects our company to a number of risks. Our ability to develop and commercialize drugs that we develop with our collaboration partners depends on our collaboration partners’ ability to establish the safety and efficacy of our product candidates, obtain and maintain regulatory approvals and achieve market acceptance of a product once commercialized. Our collaboration partners may elect to delay or terminate development of one or more product candidates, independently develop products that compete with ours, or fail to commit sufficient resources to the marketing and distribution of products developed through their collaborations with us. In the event that one or more of our collaboration partners fails to diligently develop or commercialize a product candidate covered by one of our collaboration agreements, we may have the right to terminate our partner’s rights to such product candidate but we will not receive any future revenue from that product candidate unless we are able to find another partner or commercialize the product candidate on our own, which is likely to

result in significant additional expense. Business combinations, significant changes in business strategy, litigation and/or financial difficulties may also adversely affect the willingness or ability of one or more of our collaboration partners to complete their obligations under our collaboration agreements. If our collaboration partners fail to perform in the manner we expect, our potential to develop and commercialize products through our collaborations, and to generate future revenue from the sale of these products, would be significantly reduced.

If conflicts of interest arise between our collaboration partners and us, any of them may act in their self-interest, which may be adverse to our interests.

If a conflict of interest arises between us and one or more of our collaboration partners, they may act in their own self-interest and not in the interest of our company or our stockholders. Some of our collaboration partners are conducting, and any of our future collaboration partners may conduct, multiple product development efforts within the disease area that is the subject of collaboration with our company. In some of our collaborations, we have agreed not to conduct, independently or with any third party, any research that is competitive with the research conducted under our collaborations. Our collaboration partners, however, may develop, either alone or with others, products in related fields that are competitive with the product candidates that are the subject of these collaborations. Competing products, either developed by our collaboration partners or to which our collaboration partners have rights, may result in their withdrawal of support for our product candidates.

If one or more of our collaboration partners were to breach or terminate their collaboration agreements with us or otherwise fail to perform their obligations thereunder in a timely manner, the preclinical or clinical development or commercialization of the affected product candidates or research

programs could be delayed or terminated. We do not know whether our current or any future collaboration partners will pursue alternative technologies or develop alternative product candidates, either on their own or in collaboration with others, including our competitors, as a means for developing treatments for the diseases targeted by collaboration agreements with our company.

Our proprietary rights may not adequately protect our technologies and product candidates.

Our commercial success will depend on our ability to obtain patents and maintain adequate protection for our technologies and product candidates in the United States and other countries. As of December 31, 2006, we owned or had exclusive rights to 166 issued U.S. and foreign patents and 181 pending U.S. and foreign patent applications. We will be able to protect our proprietary rights from unauthorized use by third parties only to the extent that our proprietary technologies and future products are covered by valid and enforceable patents or are effectively maintained as trade secrets.

We apply for patents covering both our technologies and product candidates, as we deem appropriate. However, we may fail to apply for patents on important technologies or product candidates in a timely fashion, or at all. Our existing patents and any future patents we obtain may not be sufficiently broad to prevent others from practicing our technologies or from developing competing products and technologies. In addition, we generally do not control the patent prosecution of subject matter that we license to and from others. Accordingly, we are unable to exercise the same degree of control over this intellectual property as we would over our own. Moreover, the patent positions of biopharmaceutical companies are highly uncertain and involve complex legal and factual questions for which important legal principles remain unresolved. As a result, the validity and enforceability of patents cannot be predicted with certainty. In addition, we do not know whether:

- we or our licensors were the first to make the inventions covered by each of our issued patents and pending patent applications;
- we or our licensors were the first to file patent applications for these inventions;

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- others will independently develop similar or alternative technologies or duplicate any of our technologies;
 - any of our or our licensors' pending patent applications will result in issued patents;
 - any of our or our licensors' patents will be valid or enforceable;
 - any patents issued to us or our licensors and collaboration partners will provide us with any competitive advantages, or will be challenged by third parties;
 - we will develop additional proprietary technologies that are patentable; or
 - the patents of others will have an adverse effect on our business.

We also rely on trade secrets to protect some of our technology, especially where we do not believe patent protection is appropriate or obtainable. However, trade secrets are difficult to maintain. While we use reasonable efforts to protect our trade secrets, our or our collaboration partners' employees, consultants, contractors or scientific and other advisors may unintentionally or willfully disclose our proprietary information to competitors. Enforcement of claims that a third party has illegally obtained and is using trade secrets is expensive, time consuming and uncertain. In addition, foreign courts are sometimes less willing than U.S. courts to protect trade secrets. If our competitors independently develop equivalent knowledge, methods and know-how, we would not be able to assert our trade secrets against them and our business could be harmed.

The composition of matter patents covering SNS-595 are due to expire in 2015. Even if SNS-595 is approved by the FDA, we may not be able to recover our development costs prior to the expiration of these patents.

The composition of our lead product candidate, SNS-595, is covered by U.S. patent 5,817,669 and its counterpart patents and patent applications in 43 foreign jurisdictions. U.S. patent 5,817,669 is due to expire on October 6, 2015, and most of its foreign counterparts are due to expire on June 6, 2015. We do not know whether patent term extensions and data exclusivity periods will be available in the future. SNS-595 must undergo extensive clinical trials before it can be approved by the FDA. We do not know when, if ever, SNS-595 will be approved by the FDA. Even if SNS-595 is approved by the FDA in the future, we may not have sufficient time to commercialize SNS-595 to enable us to recover our development costs prior to the expiration of the U.S. and foreign patents covering SNS-595. Our obligation to pay royalties to Dainippon, the company from which we licensed SNS-595, may extend beyond the patent expiration, which will further erode the profitability of this product.

The composition of matter patents covering SNS-032 are due to expire in 2018 in the U.S. Even if SNS-032 is approved by the FDA, we may not be able to recover our development costs prior to the expiration of these patents.

The composition of our product candidate SNS-032 is covered by U.S. patent 6,515,004 and its counterpart patents and patent applications in 33 foreign jurisdictions. U.S. patent 6,515,004 is due to expire on October 21, 2018, and most of its foreign counterparts are due to expire on May 9, 2021. We do not know whether patent term extensions and data exclusivity periods will be available in the future. SNS-032 must undergo extensive clinical trials before it can be approved by the FDA. We do not know when, if ever, SNS-032 will be approved by the FDA. Even if SNS-032 is approved by the FDA in the future, we may not have sufficient time to commercialize SNS-032 to enable us to recover our development costs prior to the expiration of the U.S. and foreign patents covering SNS-032. Our obligation to pay royalties to BMS, the company from which we licensed SNS-032, may extend beyond the patent expiration, which will further erode the profitability of this product.

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We may be subject to damages resulting from claims that we or our employees have wrongfully used or disclosed alleged trade secrets of our employees' former employers.

Many of our employees were previously employed at universities or biotechnology or pharmaceutical companies, including our competitors or potential competitors. We may be subject to claims that these employees or we have inadvertently or otherwise used or disclosed trade secrets or other proprietary information of their former employers. Litigation may be necessary to defend against these claims. If we fail in defending such claims, in addition to paying monetary damages, we may lose valuable intellectual property rights or personnel. A loss of key research personnel or their work product could hamper or

prevent our ability to commercialize our product candidates, which could severely harm our business. Even if we are successful in defending against these claims, litigation could result in substantial costs and be a distraction to management.

We currently have limited marketing staff and no sales or distribution organization. If we are unable to develop a sales and marketing and distribution capability on our own or through collaborations with marketing partners, we will not be successful in commercializing our future products.

We currently have no sales or distribution capabilities and limited marketing staff. We intend to establish our own sales and marketing organization with technical expertise and supporting distribution capabilities to commercialize some future products, which will be expensive and time consuming. Any failure or delay in the development of our internal sales, marketing and distribution capabilities would adversely impact the commercialization of these products. With respect to other future products, we plan to collaborate with third parties that have direct sales forces and established distribution systems. To the extent that we enter into co-promotion or other licensing arrangements, our product revenue is likely to be lower than if we directly marketed or sold our products. In addition, any revenue we receive will depend upon the efforts of third parties, which may not be successful and are only partially within our control. If we are unable to enter into such arrangements on acceptable terms or at all, we may not be able to successfully commercialize these future products. If we are not successful in commercializing our future products, either on our own or through collaborations with one or more third parties, our future product revenue will suffer and we may incur significant additional losses.

We depend on various scientific consultants and advisors for the success and continuation of our research and development efforts.

We work extensively with various scientific consultants and advisors. The potential success of our drug discovery and development programs depends, in part, on continued collaborations with certain of these consultants and advisors. We rely on certain of these consultants and advisors for expertise in our research, regulatory and clinical efforts. Our scientific advisors are not our employees and may have commitments and obligations to other entities that may limit their availability to us. We do not know if we will be able to maintain such consulting agreements or that such scientific advisors will not enter into other arrangements with competitors, any of which could have a detrimental impact on our research objectives and could have a material adverse effect on our business.

Our facilities are located near known earthquake fault zones, and the occurrence of an earthquake or other catastrophic disaster could cause damage to our facilities and equipment, which could require us to cease or curtail operations.

Our facilities are located in the San Francisco Bay Area near known earthquake fault zones and are vulnerable to significant damage from earthquakes. We are also vulnerable to damage from other types of disasters, including fires, floods, power loss, communications failures and similar events. We are in the process of designing and implementing a disaster relief plan. However, even if such a plan were in place, if any disaster were to occur, our ability to operate our business at our facilities may be seriously or

completely impaired and our research could be lost or destroyed. In addition, the unique nature of our research activities and of much of our equipment could make it difficult for us to recover from a disaster.

Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure may create uncertainty regarding compliance matters. New or changed laws, regulations and standards are subject to varying interpretations in many cases. As a result, their application in practice may evolve over time. We are committed to maintaining high standards of corporate governance and public disclosure. Complying with evolving interpretations of new or changed legal requirements may cause us to incur higher costs as we revise current practices, policies and procedures, and may divert management time and attention from revenue generating to compliance activities. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, our reputation may also be harmed. In addition, it has become more expensive for us to obtain director and officer liability insurance. Further, our board members, chief executive officer and chief financial officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified board members and executive officers, which could harm our business.

Risks Related to Our Industry

The regulatory approval process is expensive, time consuming and uncertain and may prevent us or our collaboration partners from obtaining approvals for the commercialization of some or all of our product candidates.

The research, testing, manufacturing, selling and marketing of drug candidates are subject to extensive regulation by the FDA and other regulatory authorities in the United States and other countries, which regulations differ from country to country. Neither we nor our collaboration partners are permitted to market our product candidates in the United States until we receive approval of an NDA from the FDA. Neither we nor our collaboration partners have received marketing approval for any of our product candidates. Obtaining approval of an NDA can be a lengthy, expensive and uncertain process. In addition, failure to comply with FDA and other applicable U.S. and foreign regulatory requirements may subject our company to administrative or judicially imposed sanctions, including warning letters, civil and criminal penalties, injunctions, product seizure or detention, product recalls, total or partial suspension of production, and refusal to approve pending NDAs or supplements to approved NDAs.

Regulatory approval of an NDA or NDA supplement is not guaranteed, and the approval process is expensive and may take several years. Furthermore, the development process for oncology products may take longer than other therapeutic areas. The FDA also has substantial discretion in the drug approval process. Despite the time and expense exerted, failure can occur at any stage, and we could encounter problems that cause us to abandon clinical trials or to repeat or perform additional preclinical studies and clinical trials. The number of preclinical studies and clinical trials that will be required for FDA approval varies depending on the drug candidate, the disease or condition that the drug candidate is designed to address, and the regulations applicable to any particular drug candidate. The FDA can delay, limit or deny approval of a drug candidate for many reasons, including:

- a drug candidate may not be deemed safe or effective;
- FDA officials may not find the data from preclinical studies and clinical trials sufficient;
- the FDA might not approve our or our third-party manufacturer's processes or facilities; or
- the FDA may change its approval policies or adopt new regulations.

Even if we receive regulatory approval to market our product candidates, the market may not be receptive to our products.

Even if our product candidates obtain regulatory approval, resulting products, if any, may not gain market acceptance among physicians, patients, healthcare payors and/or the medical community. We believe that the degree of market acceptance will depend on a number of factors, including:

- timing of market introduction of competitive products;
- efficacy of our product;
- prevalence and severity of any side effects;
- potential advantages or disadvantages over alternative treatments;
- strength of marketing and distribution support;
- price of our future products, both in absolute terms and relative to alternative treatments; and
- availability of reimbursement from health maintenance organizations and other third-party payors.

The potential toxicity of single and repeated doses of SNS-595 has been explored in a number of animal studies that suggest the mechanism-based dose-limiting toxicities in humans receiving SNS-595 may be similar to some of those observed in approved cytotoxic agents, including temporary toxicity to bone marrow cells, the gastrointestinal system and other systems with rapidly dividing cells. In our Phase 1 and Phase 2 clinical trials, we have witnessed the following side effects, irrespective of severity, ranging from mild to more severe: lowered white blood cell count that may lead to a serious or possibly life-threatening infection, hair loss, fatigue, nausea with or without vomiting, lowered platelet count, which may lead to an increase in bruising or bleeding, lowered red blood cell count (anemia), weakness, tiredness, shortness of breath and diarrhea.

In previous clinical trials conducted by BMS, SNS-032 has been administered by IV infusion on a once-a-week and once-every-three-weeks basis. We believe that SNS-032 will need to be administered on a more frequent basis to show efficacy. Our current Phase 1 clinical trial design for SNS-032 includes administration of SNS-032 by a one-hour IV infusion once a day for five consecutive days, followed by 16 days without the drug. This IV regimen is inconvenient for patients, and commercial success may depend on developing an effective oral formulation of SNS-032. Should the development of an oral formulation be necessary, it could be costly and result in delays for the advancement of the program, and we cannot be certain that we will be able to develop an effective oral formulation for SNS-032. In our Phase 1 clinical trial, we have witnessed the following side effects, irrespective of severity, ranging from mild to more severe: fatigue, nausea with or without vomiting, diarrhea, anorexia, injection site reaction and inflammation of the pharynx and the mucous lining of the mouth.

If our future products fail to achieve market acceptance, we may not be able to generate significant revenue to achieve or sustain profitability.

Even if we receive regulatory approval for a product candidate, we will be subject to ongoing FDA obligations and continued regulatory review, which may result in significant additional expense and limit our ability to commercialize our future products.

Any regulatory approvals that we or our collaboration partners receive for our product candidates may also be subject to limitations on the indicated uses for which the product may be marketed or contain requirements for potentially costly post-marketing follow-up studies. In addition, if the FDA approves any of our product candidates, the labeling, packaging, adverse event reporting, storage, advertising, promotion and recordkeeping for the product will be subject to extensive and ongoing regulatory requirements. The subsequent discovery of previously unknown problems with the product, including

adverse events of unanticipated severity or frequency, may result in restrictions on the marketing of the product, and could include withdrawal of the product from the market.

The FDA's policies may change and additional government regulations may be enacted that could prevent or delay regulatory approval of our product candidates. We cannot predict the likelihood, nature or extent of government regulation that may arise from future legislation or administrative action, either in the United States or abroad. If we are not able to maintain regulatory compliance, we might not be permitted to market our future products and we may not achieve or sustain profitability.

The coverage and reimbursement status of newly approved drugs is uncertain, and failure to obtain adequate coverage and reimbursement could limit our ability to market any future products we may develop and decrease our ability to generate revenue.

There is significant uncertainty related to the third party coverage and reimbursement of newly approved drugs both nationally and internationally. The commercial success of our future products in both domestic and international markets depends on whether third-party coverage and reimbursement is available for the ordering of our future products by the medical profession for use by their patients. Medicare, Medicaid, health maintenance organizations and other third-party payors are increasingly attempting to manage healthcare costs by limiting both coverage and the level of reimbursement of new drugs and, as a result, they may not cover or provide adequate payment for our future products. These payors may not view our future products as cost-effective, and reimbursement may not be available to consumers or may not be sufficient to allow our future products to be marketed on a competitive basis. Likewise, legislative or regulatory efforts to control or reduce healthcare costs or reform government healthcare programs could result in lower prices or rejection of our future products. Changes in coverage and reimbursement policies or healthcare cost containment initiatives that limit or restrict reimbursement for our future products may reduce any future product revenue.

Failure to obtain regulatory approval in foreign jurisdictions will prevent us from marketing our products abroad.

We intend to market our future products in international markets. In order to market our future products in Canada, the European Union and many other foreign jurisdictions, we must obtain separate regulatory approvals. We have had limited interactions with foreign regulatory authorities, and the approval procedures vary among countries and can involve additional testing at significant cost, and the time required to obtain approval may differ from that required to obtain FDA approval. Approval by the FDA does not ensure approval by regulatory authorities in other countries, and approval by one foreign regulatory authority does not ensure approval by regulatory authorities in other foreign countries or by the FDA. The foreign regulatory approval process may include all of the risks associated with obtaining FDA approval. We may not obtain foreign regulatory approvals on a timely basis, if at all. We may not be able to file for regulatory approvals and may not receive necessary approvals to commercialize our products in any market.

We may incur significant costs complying with environmental laws and regulations, and failure to comply with these laws and regulations could expose us to significant liabilities.

We use hazardous chemicals and radioactive and biological materials in our business and are subject to a variety of federal, state and regional local laws and regulations governing the use, generation, manufacture, storage, handling and disposal of these materials. Although we believe our safety procedures for handling and disposing of these materials and waste products comply with these laws and regulations, we cannot eliminate the risk of accidental injury or contamination from the use, storage, handling or disposal of hazardous materials. In the event of contamination or injury, we could be held liable for any

resulting damages, and any liability could significantly exceed our insurance coverage, which is limited to \$100,000 for pollution cleanup, and we are uninsured for third-party contamination injury.

We may be subject to costly claims related to our clinical trials and may not be able to obtain adequate insurance.

Because we conduct clinical trials in humans, we face the risk that the use of our product candidates will result in adverse side effects. We cannot predict the possible harms or side effects that may result from our clinical trials. Although we have clinical trial liability insurance for up to \$10.0 million, our insurance may be insufficient to cover any such events. We do not know whether we will be able to continue to obtain clinical trial coverage on acceptable terms, or at all. We may not have sufficient resources to pay for any liabilities resulting from a claim excluded from, or beyond the limit of, our insurance coverage. There is also a risk that third parties that we have agreed to indemnify could incur liability. Any litigation arising from our clinical trials, even if we were ultimately successful, would consume substantial amounts of our financial and managerial resources and may create adverse publicity.

Foreign governments often impose strict price controls, which may adversely affect our future profitability.

We intend to seek approval to market our future products in both the United States and foreign jurisdictions. If we obtain approval in one or more foreign jurisdictions, we will be subject to rules and regulations in those jurisdictions relating to our product. In some foreign countries, particularly in the European Union, prescription drug pricing is subject to governmental control. In these countries, pricing negotiations with governmental authorities can take considerable time after the receipt of marketing approval for a drug candidate. To obtain reimbursement or pricing approval in some countries, we may be required to conduct a clinical trial that compares the cost-effectiveness of our future product to other available therapies. If reimbursement of our future products is unavailable or limited in scope or amount, or if pricing is set at unsatisfactory levels, we may be unable to achieve or sustain profitability.

Risks Related to Our Common Stock

The price of our common stock may continue to be volatile, and the value of an investment in our common stock may decline.

We sold shares of common stock in our IPO in September 2005 at a price of \$7.00 per share, and our stock has subsequently traded as low as \$4.03 per share. An active and liquid trading market for our common stock may not develop or be sustained. Factors that could cause volatility in the market price of our common stock include, but are not limited to:

- results from, and any delays in or discontinuance of, our clinical trial programs, including our ongoing and planned clinical trials for SNS-595, SNS-032 and SNS-314;
- announcements of FDA non-approval of our product candidates, including SNS-595, SNS-032 or SNS-314, delays in filing regulatory documents with the FDA or other regulatory agencies, or delays in the review process by the FDA or other foreign regulatory agencies;
- failure or discontinuation of any of our research programs;
- announcements relating to future collaborations or our existing collaborations with Biogen Idec, Johnson & Johnson PRD and Merck;
- delays in the commercialization of our future products;
- market conditions in the pharmaceutical, biopharmaceutical and biotechnology sectors and issuance of new or changed securities analysts' reports or recommendations;
- actual and anticipated fluctuations in our quarterly operating results;

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- developments or disputes concerning our intellectual property or other proprietary rights;
 - introduction of technological innovations or new products by us or our competitors;
 - issues in manufacturing our product candidates or future products;
 - market acceptance of our future products;
 - deviations in our operating results from the estimates of analysts;
 - third-party healthcare reimbursement policies;
 - FDA or other U.S. or foreign regulatory actions affecting us or our industry;
 - litigation or public concern about the safety of our product candidates or future drugs;
 - sales of our common stock by our officers, directors or significant stockholders; and
 - additions or departures of key personnel.

In addition, the stock markets in general, and the markets for pharmaceutical, biopharmaceutical and biotechnology stocks in particular, have experienced extreme volatility that have been often unrelated to the operating performance of the issuer. These broad market fluctuations may adversely affect the trading price or liquidity of our common stock. In the past, when the market price of a stock has been volatile, holders of that stock have sometimes

instituted securities class action litigation against the issuer. If any of our stockholders were to bring such a lawsuit against us, we could incur substantial costs defending the lawsuit and the attention of our management would be diverted from the operation of our business.

The ownership of our common stock is highly concentrated, and your interests may conflict with the interests of our existing stockholders.

Our executive officers and directors and their affiliates, together with our current significant stockholders, beneficially owned approximately 60.6% of our outstanding common stock as of February 9, 2007. Accordingly, these stockholders, acting as a group, have significant influence over the outcome of corporate actions requiring stockholder approval, including the election of directors, any merger, consolidation or sale of all or substantially all of our assets or any other significant corporate transaction. These stockholders could delay or prevent a change of control of our company, even if such a change of control would benefit our other stockholders. The significant concentration of stock ownership may adversely affect the trading price of our common stock due to investors' perception that conflicts of interest may exist or arise.

If we sell shares of our common stock in future financings, common stockholders may experience immediate dilution and, as a result, our stock price may go down.

We may from time to time issue additional shares of common stock at a discount from the current trading price of our common stock. As a result, our common stockholders would experience immediate dilution upon the purchase of any shares of our common stock sold at such discount.

In addition, as opportunities present themselves, we may enter into financing or similar arrangements in the future, including the issuance of debt securities, preferred stock or common stock. In March 2006, we issued common stock and warrants in a private placement resulting in gross proceeds of approximately \$45.3 million. In November 2006, we filed a \$75 million universal shelf registration statement on Form S-3 with the Securities and Exchange Commission, or SEC. The registration statement which was declared effective on December 8, 2006, will enable the Company to issue registered securities from time to time. If we issue common stock or securities convertible into common stock, our common stockholders could experience dilution.

Provisions of our charter documents or Delaware law could delay or prevent an acquisition of our company, even if the acquisition would be beneficial to our stockholders, and could make it more difficult to change management.

Provisions of our amended and restated certificate of incorporation and amended and restated bylaws may discourage, delay or prevent a merger, acquisition or other change in control that stockholders may consider favorable, including transactions in which stockholders might otherwise receive a premium for their shares. In addition, these provisions may frustrate or prevent any attempt by our stockholders to replace or remove our current management by making it more difficult to replace or remove our board of directors. These provisions include:

- a classified board of directors so that not all directors are elected at one time;
- a prohibition on stockholder action through written consent;
- limitations on our stockholders' ability to call special meetings of stockholders;
- an advance notice requirement for stockholder proposals and nominations; and
- the authority of our board of directors to issue preferred stock with such terms as our board of directors may determine.

In addition, Delaware law prohibits a publicly held Delaware corporation from engaging in a business combination with an interested stockholder, generally a person who, together with its affiliates, owns or within the last three years has owned 15% of our voting stock, for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner. Accordingly, Delaware law may discourage, delay or prevent a change in control of our company.

Provisions in our charter and other provisions of Delaware law could limit the price that investors are willing to pay in the future for shares of our common stock.

We have never paid dividends on our capital stock and we do not anticipate paying any cash dividends in the foreseeable future.

We have never declared or paid cash dividends on our capital stock. We do not anticipate paying any cash dividends on our capital stock in the foreseeable future. We currently intend to retain all available funds and any future earnings to fund the development and growth of our business. As a result, capital appreciation, if any, of our common stock will be our stockholders' sole source of gain for the foreseeable future.

Changes in financial accounting standards related to share-based payments are expected to continue to have a significant effect on our reported results.

On January 1, 2006, we adopted Statement of Financial Accounting Standards No. FAS 123 (revised 2004) (FAS 123R), "Share-Based Payment," which requires that we record compensation expense in the statement of operations for share-based payments, such as employee stock options, using the fair value method. The adoption of this new standard is expected to continue to have a significant effect on our reported results of operations, although it will not affect our cash flows, and could adversely impact our ability to provide accurate guidance on our future reported financial results due to the variability of the factors used to estimate the values of share-based payments. If factors change and we employ different assumptions or different valuation methods in the application of FAS 123R in future periods, the compensation expense that we record under FAS 123R may differ significantly from what we have recorded in the current period, which could negatively affect our stock price and our stock price volatility.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease approximately 54,000 square feet of office and laboratory space in South San Francisco, California. Our lease expires in June 2013, subject to our option to extend the lease through June 2018.

In December 2006, we leased approximately 15,000 square feet of additional office space in a building near to our main office in South San Francisco, California beginning March 1, 2007. This lease expires in April 2013, subject to our option to extend the lease through February 2014. We believe that our current facilities will be sufficient to meet our needs through the first half of 2009.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we may be involved in litigation relating to claims arising out of our operations. We are not currently involved in any material legal proceedings.

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

Not applicable.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock, par value \$0.0001 per share, has been traded on the Nasdaq National Market and subsequently, the Nasdaq Global Market, since September 27, 2005 under the symbol SNSS.

Prior to such time, there was no public market for our common stock. The following table sets forth the range of the high and low sales prices by quarter as reported by the Nasdaq Global Market.

<u>Fiscal 2005</u>	<u>High</u>	<u>Low</u>
Third Quarter (commencing September 27, 2005)	\$ 7.09	\$ 6.25
Fourth Quarter	\$ 7.01	\$ 4.25
<u>Fiscal 2006</u>	<u>High</u>	<u>Low</u>
First Quarter	\$ 7.40	\$ 4.47
Second Quarter	\$ 7.25	\$ 5.79
Third Quarter	\$ 6.20	\$ 4.14
Fourth Quarter	\$ 5.75	\$ 4.03

As of March 1, 2007, there were approximately 245 holders of record of our common stock. This number does not include the number of persons whose shares are in nominee or in "street name" accounts through brokers. On March 1, 2007, the last sale price reported on the Nasdaq Global Market for our common stock was \$4.36 per share.

Dividend Policy

We have never paid cash dividends on our common stock. We do not anticipate paying any cash dividends on our capital stock in the foreseeable future. While subject to periodic review, the current policy of our Board of Directors is to retain cash and investments primarily to provide funds for our future growth.

Securities Authorized For Issuance Under Equity Compensation Plans as of December 31, 2006:

<u>Plan Category</u>	<u>(A)</u> <u>Number of Securities</u> <u>to be Issued</u> <u>upon Exercise of</u> <u>Outstanding Options</u> <u>and Rights</u>	<u>(B)</u> <u>Weighted Average</u> <u>Exercise Price of</u> <u>Outstanding Options</u> <u>and Rights</u>	<u>(C)</u> <u>Number of Securities</u> <u>Remaining Available for</u> <u>Future Issuance Under</u> <u>Equity Compensation Plans</u> <u>(Excluding Securities</u> <u>Reflected in Column A)</u>
Equity Compensation Plans			
Approved by Stockholders(1)	3,822,435(2)	\$ 3.53	561,581(3)
Equity Compensation Plans Not			
Approved by Stockholders(4)	120,000	\$ 5.71	80,000
Total	3,942,435	\$ 3.57	641,581

(1) Includes our 1998 Stock Plan, or 1998 Plan, 2001 Stock Plan, or 2001 Plan, 2005 Equity Incentive Award Plan, or 2005 Plan, and Employee Stock Purchase Plan, or ESPP.

(2) Includes (i) 1,310,370 shares of common stock issuable upon the exercise of options granted under our 1998 Plan, all of which were exercisable as of December 31, 2006, (ii) 229,969 shares of common stock issuable upon the exercise of options granted under our 2001 Plan, all of which were exercisable as of December 31, 2006, and (iii) 2,282,096 shares of common stock issuable upon the exercise of options granted under our 2005 Plan, 403,282 of which were exercisable as of December 31, 2006. Excludes purchase rights currently accruing under the ESPP. Offering periods under the ESPP are 12-month periods, which are comprised of two six-month purchase periods. Eligible employees may purchase shares of common stock at a price equal to 85% of the lower of the fair market value of the common stock at the beginning of each offering period or the end of each semi-annual purchase period. Participation is limited to 20% of an employee's eligible compensation, subject to limitations under the Code.

(3) Includes (i) 396,716 shares of common stock available for issuance under our 2005 Plan and (ii) 164,865 shares of common stock available for issuance under our Employee Stock Purchase Plan, or ESPP. 202,941 shares of our common stock were initially reserved for issuance under our ESPP. The number of shares of common stock reserved under our ESPP will automatically increase on the first trading day each year, beginning in 2006, by an amount equal to the least of: (i) 0.5% of our outstanding shares of common stock outstanding on such date, (ii) 135,294 shares or (iii) a lesser amount determined by our Board of Directors. The maximum aggregate number of shares which may be issued over the term of the ESPP is 1,352,941 shares.

(4) Our 2006 Employment Commencement Incentive Plan, or 2006 Plan, became effective on January 1, 2006. Effective January 1, 2007, our Board of Directors increased the 2006 Plan by an additional 200,000 shares such that the aggregate number of shares of our common stock reserved for issuance under our 2006 Plan, which did not require stockholder approval pursuant to Nasdaq Marketplace Rule 4350(i)(1)(A)(iv), is 400,000 shares.

The additional information required by this Item 5 concerning our equity compensation plans is discussed in Note 11 to the financial statements contained in Part II Item 8 of this report.

Unregistered Sales of Equity Securities

In March 2006, we issued an aggregate of 7,246,377 shares of common stock and warrants to purchase up to an additional 2,173,914 shares of common stock to funds managed by Alta Partners, Deerfield

Management, Baker Brothers Investments, Warburg Pincus LLC and several other institutional investors, each of whom represented that it was an accredited investor, for an aggregate purchase price of \$45,300,000 in a private placement transaction.

We claimed exemption from registration under the Securities Act for the sale and issuance of securities in the transactions described above by virtue of Section 4(2) of the Securities Act of 1933, as amended, and/or Regulation D promulgated thereunder as transactions not involving any public offering. All of the purchasers of unregistered securities for which we relied on Section 4(2) and/or Regulation D represented that they were accredited investors as defined under the Securities Act. We claimed such exemption on the basis that (a) the purchasers in each case represented that they intended to acquire the securities for investment only and not with a view to the distribution thereof and that they either received adequate information about us or had access, through employment or other relationships, to such information and (b) appropriate legends were affixed to the stock certificates issued in such transactions.

Use of Proceeds From Registered Securities

The initial public offering of 6,051,126 shares of our common stock was effected through a Registration Statement on Form S-1 (Reg. No. 333-121646) which was declared effective by the Securities and Exchange Commission on September 27, 2005. We issued 6,000,000 shares on September 30, 2005 for gross proceeds of \$42,000,000. We issued 51,126 shares on November 1, 2005 for gross proceeds of \$358,000. We paid the underwriters a commission of \$2,965,000 and incurred additional offering expenses of approximately \$2,225,000. After deducting the underwriters' commission and the offering expenses, we received net proceeds of approximately \$37,168,000.

No payments for such expenses were made directly or indirectly to (i) any of our directors, officers or their associates, (ii) any person(s) owning 10% or more of any class of our equity securities or (iii) any of our affiliates.

The net proceeds have been invested into short-term investment grade securities and money market accounts. We have begun, and intend to continue to use, our net proceeds to fund clinical and preclinical development of our product candidates, to discover additional product candidates, to repay outstanding indebtedness and for general corporate purposes, including capital expenditures and working capital. We also used a portion of our net proceeds from our initial public offering to repay Biogen Idec \$4.0 million with interest that we owed pursuant to a promissory note executed in favor of Biogen Idec in December 2002. We may use a portion of our net proceeds to in-license product candidates or to invest in businesses or technologies that we believe are complementary to our own.

Issuer Purchases of Equity Securities

<u>Period</u>	<u>Total Number of Shares Purchases</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Maximum Number of Shares that May Yet be Purchased under the Plans or Programs</u>
2006	710(1)	\$ 2.55	—	—

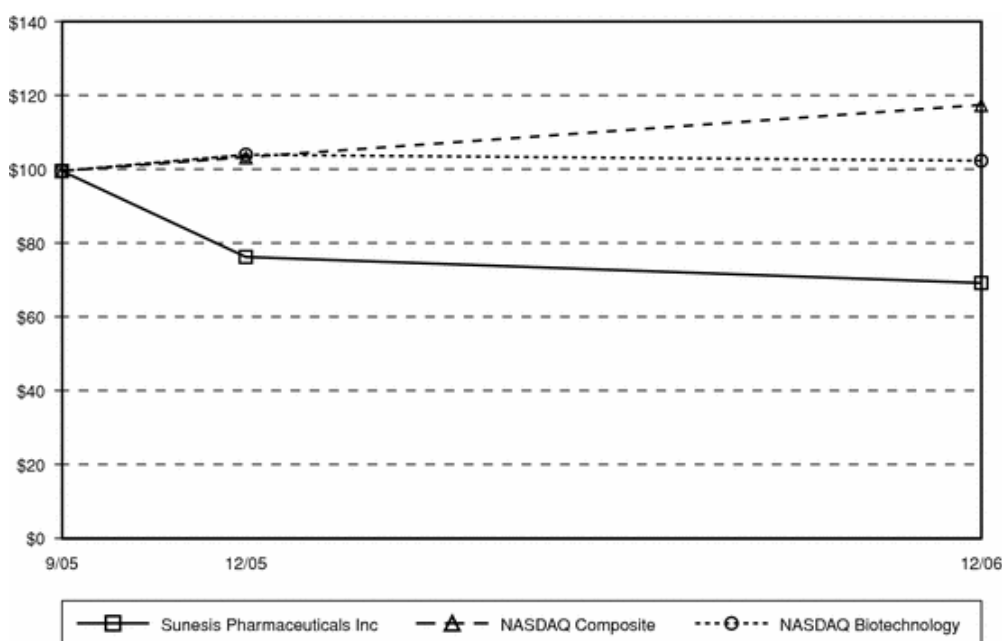
(1) This repurchase was not made through a publicly announced plan. We repurchased 710 shares of common stock from an employee whom had early exercised the options and then was subsequently terminated.

Performance Graph

The following graph compares our cumulative total stockholder return since September 27, 2005 with the NASDAQ Composite Index and the NASDAQ Biotechnology Index composed of other companies with similar business models. The graph assumes that the value of the investment in our common stock and each index was \$100.00 on September 27, 2005.

COMPARISON OF 15 MONTH CUMULATIVE TOTAL RETURN*

Among Sunesis Pharmaceuticals Inc, The NASDAQ Composite Index
And The NASDAQ Biotechnology Index



* \$100 invested on 9/27/05 in stock or on 8/31/05 in index-including reinvestment of dividends.
Fiscal year ending December 31.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our financial statements and notes to those statements included elsewhere in this report.

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(In thousands, except per share amounts)				
Statement of Operations Data:					
Revenues:					
Collaboration revenue	\$ 6,353	\$ 7,395	\$ 5,938	\$ 6,842	\$ 3,170
Collaboration revenue from related party	7,318	9,018	4,201	857	32
Grant and fellowship revenue	38	109	166	561	1,474
Total revenues	<u>13,709</u>	<u>16,522</u>	<u>10,305</u>	<u>8,260</u>	<u>4,676</u>
Operating expenses:					
Research and development	35,615	36,166	23,616	21,326	18,441
General and administrative	12,255	8,283	7,352	6,136	6,179
Total operating expenses	<u>47,870</u>	<u>44,449</u>	<u>30,968</u>	<u>27,462</u>	<u>24,620</u>
Loss from operations	(34,161)	(27,927)	(20,663)	(19,202)	(19,944)
Interest income	3,395	1,092	518	713	1,360
Interest expense	(478)	(674)	(387)	(521)	(594)
Other income (expense), net	7	10	2	5	(4)
Net loss	<u>(31,237)</u>	<u>(27,499)</u>	<u>(20,530)</u>	<u>(19,005)</u>	<u>(19,182)</u>
Convertible preferred stock deemed dividend	—	(88,092)	—	—	—
Loss applicable to common stockholders	<u>\$ (31,237)</u>	<u>\$ (115,591)</u>	<u>\$ (20,530)</u>	<u>\$ (19,005)</u>	<u>\$ (19,182)</u>
Basic and diluted loss per share applicable to common stockholders	<u>\$ (1.13)</u>	<u>\$ (17.41)</u>	<u>\$ (15.77)</u>	<u>\$ (16.16)</u>	<u>\$ (18.73)</u>
Shares used in computing basic and diluted loss per share applicable to common stockholders	<u>27,758,348</u>	<u>6,637,935</u>	<u>1,302,096</u>	<u>1,175,766</u>	<u>1,024,024</u>

	As of December 31,				
	2006	2005	2004	2003	2002
	(In thousands)				
Balance Sheet Data:					
Cash, cash equivalents and marketable securities	\$ 63,105	\$ 48,333	\$ 36,812	\$ 33,843	\$ 47,155
Working capital	55,279	40,156	27,707	27,208	42,219
Total assets	69,276	54,708	43,026	40,306	54,346
Long-term debt	956	1,306	4,438	3,249	2,593
Convertible preferred stock	—	—	108,813	94,821	94,821
Common stock and additional paid-in capital	298,077	249,692	6,494	2,723	2,637
Accumulated deficit	(240,245)	(209,008)	(93,417)	(72,886)	(53,881)
Total stockholders’ equity (deficit)	56,804	38,466	(90,044)	(70,376)	(51,428)

ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read together with our financial statements and related notes included elsewhere in this report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not

Overview

We are a clinical-stage biopharmaceutical company focused on the discovery, development and commercialization of novel small molecule therapeutics for oncology and other unmet medical needs. We have developed a proprietary fragment-based drug discovery approach, called “Tethering®,” that we combine with other drug discovery tools, such as structure-based design and medicinal chemistry, to discover and develop novel therapeutics. We have built our product candidate portfolio through internal discovery and the in-licensing of novel cancer therapeutics. We are advancing our product candidates through in-house research and development efforts and strategic collaborations with leading pharmaceutical and biopharmaceutical companies.

From our incorporation in 1998 through 2001, our operations consisted primarily of developing and refining our drug discovery technologies. Since 2002, we have focused on developing novel small molecule drugs mainly to treat cancer and other unmet medical needs.

We are advancing three proprietary oncology product candidates, SNS-595, SNS-032 and SNS-314, through in-house research and development efforts. Our lead product candidate, SNS-595, is a novel cell cycle inhibitor. With SNS-595, we are currently conducting one Phase 2 clinical trial in small cell lung cancer, one Phase 2 clinical trial in ovarian cancer and one Phase 1 clinical trial in acute leukemias. Our second most advanced product candidate, SNS-032, is a CDK inhibitor. We are currently conducting a Phase 1 clinical trial with SNS-032 in patients with advanced solid tumors and a Phase 1 clinical trial in patients with advanced B-cell malignancies. We are also developing SNS-314, an Aurora kinase inhibitor, for the treatment of cancer for which we filed an IND in February 2007. We have worldwide development and commercialization rights to SNS-595, SNS-032 (for diagnostic and therapeutic applications) and SNS-314. We may in the future enter into collaborations to maximize the commercial potential of these programs.

As of February 28, 2007, we had four ongoing strategic collaborations, one of which involves active participation by our personnel, with three leading pharmaceutical and biopharmaceutical companies. As of December 31, 2006, we had received an aggregate of approximately \$74.1 million in cash from our current and former collaboration partners in the form of stock purchase proceeds and fees from our current and former collaboration partners.

Since our inception, we have generated significant losses. As of December 31, 2006, we had an accumulated deficit of \$240.2 million, including a deemed dividend of \$88.1 million recorded in conjunction with our IPO in September 2005. We expect our net losses to increase primarily due to our anticipated clinical trial activities.

Financial Operations Overview

Revenue

We have not generated any revenue from sales of commercial products and do not expect to generate any product revenue for the foreseeable future. To date, our revenue has consisted of collaboration revenue and grant and fellowship revenue.

Collaboration Revenue. We generate revenue primarily through our collaborations. As of February 28, 2007, we had four ongoing research-based collaborations, one of which involves the participation of our personnel. Each of these collaborations included a technology access fee, research funding, milestone payments and royalties upon sales of future products that may result from the collaborations. The table below sets forth our revenue since January 1, 2004 from each of our current collaborators.

	Year Ended December 31,		
	2006	2005	2004
	(In thousands)		
Biogen Idec (a related party)	\$ 7,318	\$ 9,018	\$ 4,201
Johnson & Johnson PRD	—	1,418	1,334
Merck	6,353	5,977	4,604
Total	<u>\$ 13,671</u>	<u>\$ 16,413</u>	<u>\$ 10,139</u>

In May 2002, we entered into our collaboration with Johnson & Johnson PRD, the research phase of which was completed in December 2005. In December 2002, we entered into our initial collaboration with Biogen Idec, the research phase of which was completed in June 2005. In February 2003, we entered into our initial collaboration with Merck, the research phase of which was completed in February 2006. In July 2004, we entered into a second collaboration with Merck. In August 2004, we entered into a second collaboration with Biogen Idec.

In 2007 and 2008, we expect to receive additional research funding from our collaborators totaling at least \$9.2 million. This funding is discretionary, but is not dependent upon the achievement of milestones. In addition, we may receive milestone payments if one or more of our research collaboration programs reach a milestone for which a payment is due. In 2006, milestone payments earned totaled \$4.8 million. In the absence of any new collaborations, we expect our collaboration revenue to be lower in future years than in 2006.

Grant and Fellowship Revenue. Grant and fellowship revenue is recognized as we perform services under the applicable grant. As of December 31, 2006, we had been awarded an aggregate of \$5.4 million, and had recognized as revenue \$2.5 million, in federal grants under the Small Business Innovation Research, or SBIR, program. In addition, we have recognized revenue from other grants and fellowships. Grant and fellowship revenues recognized were \$38,000, \$109,000 and \$166,000 for the periods ended December 31, 2006, 2005, and 2004, respectively. We do not plan to perform any work under additional SBIR grants in the foreseeable future.

Research and Development Expense

Most of our operating expenses to date have been for research and development activities. Research and development expense represents costs incurred to discover and develop novel small molecule therapeutics, including Phase 1 and Phase 2 clinical trial costs for SNS-595 and Phase 1 clinical trial costs for SNS-032, to develop our proprietary fragment-based Tethering® drug discovery approach, to develop in-house research and preclinical study capabilities, to discover and advance product candidates toward clinical trials, including our SNS-314 Aurora kinase program, and in connection with in-licensing activities. We expense all research and development costs as they are incurred. The table below sets forth our research and development expense since January 1, 2004 for our product candidate programs.

	Year Ended December 31,		
	2006	2005	2004
	(In thousands)		
SNS-595	\$ 8,420	\$ 7,230	\$ 4,587
SNS-032	5,446	9,665	—
SNS-314	5,238	7,102	3,688
RAF kinase inhibitors	1,482	1,552	2,967
Other kinase inhibitors	10,728	5,473	879
Cathepsin S inhibitors	7	796	967
BACE inhibitors for Alzheimer's disease	316	1,674	2,266
Anti-viral inhibitors	—	37	32
TNF family and oncology research	3	951	2,526
Other programs	3,976	1,686	5,704
Total	<u>\$35,616</u>	<u>\$ 36,166</u>	<u>\$ 23,616</u>

We in-licensed SNS-032 from Bristol-Myers Squibb Company, or BMS, in April 2005 and issued BMS shares of our Series C-2 preferred stock, with an initial value of \$8.0 million. These shares were converted into 879,094 shares of common stock in conjunction with our IPO in September 2005. The \$8.0 million up-front payment was included in research and development expense for the period ended December 31, 2005 due to uncertainties surrounding the remaining efforts for completion of the research and development activities. In February 2006, as consideration for a milestone payment due pursuant to the license agreement for initiating a Phase 1 clinical trial, we issued an aggregate of 404,040 shares of our common stock to BMS and recorded a non-cash research and development expense of \$2.0 million.

We incur research and development expense associated with both partnered and unpartnered research activities, as well as the development and expansion of our drug discovery technologies. Research and development expense relating to our collaborations with Biogen Idec and Merck consist primarily of costs related to Tethering®, lead optimization, preclinical studies and other activities related to the identification and optimization of compounds for development of kinase inhibitors for the treatment of cancer, cytokine and enzyme inhibitors for the treatment of inflammatory diseases, antiviral inhibitors for the treatment of viral disease as well as protease inhibitors for the treatment of Alzheimer's disease. Under our Biogen Idec agreement, we have an option on a target-by-target basis to co-fund post-Phase 1 development costs for up to two oncology kinase targets, which may include Raf kinase. If we exercise one or both of our options, our research and development expense will increase significantly. Research and development expense related to co-development activities that we elect to co-fund would consist primarily of manufacturing costs for the product candidate, clinical trial-related costs, costs for consultants and contract research employee compensation and facilities costs and depreciation of equipment.

We expect to incur research and development expense to conduct clinical trials on SNS-595, SNS-032 and SNS-314. Clinical trials are costly, and as we continue to advance our product candidates through preclinical and clinical development, we expect our research and development expense to increase. For

example, we expect to spend at least \$18 million (1) to advance our SNS-595 program to completion of Phase 2 clinical trials in small cell lung cancer and ovarian cancer and ongoing and planned Phase 1 and Phase 2 clinical trials in acute leukemias, (2) to advance our SNS-032 program to completion of our ongoing and planned Phase 1 clinical trials, and (3) to complete a Phase 1 clinical trial for SNS-314. As of the date of this report, due to the risks inherent in the clinical trial process and given the early state of development of our programs, we are unable to estimate the costs we will incur in the continued development of our product candidates for potential commercialization.

Due to these same factors, we are unable to determine the anticipated completion dates for our current research and development programs. Clinical development timelines, probability of success and development costs vary widely. While we are currently focused on advancing SNS-595, SNS-032 and SNS-314 through clinical development, we anticipate that we will make determinations as to which programs to pursue and how much funding to direct to each program on an ongoing basis in response to the scientific and clinical success of each product candidate, as well as an ongoing assessment as to the product candidate's commercial potential. In addition, we cannot forecast which product candidates will be subject to future collaborative or licensing arrangements, when such arrangements will be secured, if at all, and to what degree such arrangements would affect our development plans and capital requirements. As a result, we do not know when and to what extent we will receive cash inflows from our product candidates.

General and Administrative Expense

Our general and administrative expense consists primarily of salaries and other related costs for personnel in finance, human resources, facilities management, legal, including intellectual property management, general administration and non-cash stock compensation. Other significant costs include facilities costs and fees paid to outside legal advisors and auditors.

Critical Accounting Policies and the Use of Estimates

This discussion and analysis of our financial condition and results of operations is based on our financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as revenue and expenses during the reporting periods. We evaluate our estimates and judgments on an ongoing basis. We base our estimates on historical experience and on various other factors we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results could therefore differ materially from those estimates under different assumptions or conditions.

Our significant accounting policies are more fully described in Note 1 to our financial statements included elsewhere in this report. We believe the following critical accounting policies reflect our more significant estimates and assumptions used in the preparation of our financial statements.

Revenue Recognition

In accordance with Emerging Issues Task Force, or EITF, 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*, which we adopted effective July 1, 2003, revenue arrangements with multiple deliverable items are divided into separate units of accounting based on whether certain criteria are met, including whether the delivered item has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. We allocate the consideration we receive among the separate units of accounting based on their respective fair value, and we apply the applicable revenue recognition criteria to each of the separate units. Where an item in a revenue arrangement with

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multiple deliverables does not constitute a separate unit of accounting and for which delivery has not occurred, we defer revenue until the delivery of the item is completed.

We record upfront, non-refundable license fees and other fees received in connection with research and development collaborations as deferred revenue and recognize these amounts ratably over the relevant period specified in the agreements, generally the research term.

We recognize research funding related to collaborative research with our collaboration partners as the related research services are performed. This funding is normally based on a specified amount per full-time equivalent employee per year.

We recognize revenue from milestone payments, which are substantially at risk at the time the collaboration agreement is entered into, upon completion of the applicable milestone events. We intend to recognize any future royalty revenue based on reported product sales by third-party licensees.

We recognize grant revenue from government agencies and private research foundations as the related qualified research and development costs are incurred, up to the limit of the prior approval funding amounts.

Clinical Trial Accounting

We record accruals for estimated clinical trial costs, comprising payments for work performed by contract research organizations and participating clinical trial sites. These costs may be a significant component of future research and development expense. We accrue costs for clinical trials performed by contract research organizations based on estimates of work performed under the contracts. Costs of setting up clinical trial sites for participation in trials are expensed immediately. Costs related to patient enrollment are accrued as patients are entered in the trial reduced by an initial payment made to the hospital when the first patient is enrolled. These cost estimates may or may not match the actual costs incurred for services performed by the organizations as determined by patient enrollment levels and related activities. If we have incomplete or inaccurate information, we may underestimate costs associated with various trials at a given point in time. Although our experience in estimating these costs is limited, the difference between accrued expenses based on our estimates and actual expenses have not been material to date.

Stock-Based Payments

The Company grant options to purchase common stock to its employees, directors and consultants under its stock option plans. Eligible employees can also purchase shares of common stock at 85% of the lower of the fair market value of the common stock at the beginning of an offering period or at the purchase date.

The Company account for stock compensation arrangements to non-employees in accordance with EITF No. 96-18, *Accounting for Equity Instruments That Are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*, using a fair value approach. The compensation costs of these arrangements are subject to remeasurement over the vesting terms as earned.

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "*Share-Based Payment*" ("FAS 123R"), which supersedes the previous accounting under APB Opinion No. 25, "*Accounting for Stock Issued to Employees*" ("APB 25"). Under FAS 123R, share-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as expense over the employee's requisite service period. The Company has no awards with market or performance conditions. The Company adopted the provisions of FAS 123R using the modified prospective transition method for awards granted on or after December 23, 2004, the date on which the Company filed its initial registration statement on Form S-1 with the Securities and Exchange Commission

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("SEC") in connection with its IPO. The prospective transition method has been applied to options granted prior to December 23, 2004. Under the modified prospective transition method, compensation cost recognized during the year ended December 31, 2006, includes: (a) compensation cost for all share-based payments granted subsequent to the initial filing of the Company's Form S-1 on December 23, 2004, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 (as defined below) and amortized on a straight-line basis over the options' vesting period; and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of FAS 123R amortized on a straight-line basis over the options' vesting period. Under the prospective transition method, options granted prior to the initial filing of the Company's Form S-1 will continue to be accounted for in accordance with APB 25 and Financial Accounting Standards Board ("FASB") Interpretation No. 44 ("FIN 44"), *Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB No. 25*, which were the accounting principles originally applied to those awards.

The valuation provisions of FAS 123R apply to new awards and to awards that are outstanding on the effective date and subsequently modified or cancelled. Estimated compensation expense for awards outstanding at the effective date will be recognized over the remaining service period using the compensation cost calculated for pro forma disclosure purposes under FASB Statement No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"). As stock-based compensation expense recognized in the Statement of Operations for fiscal 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. FAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company reviewed its forfeiture estimates on a quarterly basis during 2006. In the Company's pro forma

information required under SFAS 123 for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred. The Company's Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of FAS 123R.

Upon adoption of FAS 123R, the Company retained its method of valuation for share-based awards granted beginning in fiscal 2006 with the use of the Black-Scholes option-pricing model ("Black-Scholes model") which was previously used for the Company's pro forma information required under SFAS 123. The Company's determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the Company's expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

FAS 123R requires the cash flows resulting from the tax benefits related to tax deductions in excess of the compensation costs recognized for these options (excess tax benefits) to be classified as financing cash flows.

On November 10, 2005, the FASB issued FASB Staff Position No. FAS 123(R)-3, "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards." The Company has elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of share-based compensation pursuant to FAS 123R. The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool related to the tax effects of employee share-based compensation, which is available to absorb tax deficiencies recognized subsequent to the adoption of FAS 123R.

Results of Operations

Years Ended December 31, 2006 and 2005

Revenue. Revenue decreased from \$16.5 million in 2005 to \$13.7 million in 2006. Collaboration revenue decreased from \$16.4 million in 2005 to \$13.7 million in 2006, primarily due to a \$1.7 million decrease in collaboration revenue from Biogen Idec and a \$1.4 million decrease in collaboration revenue from Johnson & Johnson PRD. The decrease in collaboration revenue from Biogen Idec and Johnson & Johnson PRD resulted from the completion of the research phase of collaborations with these companies in 2005. Grant and fellowship revenue decreased from \$109,000 in 2005 to \$38,000 in 2006, primarily due to our decision in 2003 to only perform limited additional work under SBIR grants for the foreseeable future.

Research and development expense. Research and development expense decreased from \$36.2 million in 2005 to \$35.6 million in 2006, primarily due to a \$8.0 million expense related to the in-license of SNS-032 in April 2005 versus a \$2.0 million milestone payment paid for SNS-032 in 2006. Without these non-cash licensing and milestone-related expenses for SNS-032, research and development expenses increased from \$28.2 million in 2005 to \$33.6 million in 2006 primarily due to (i) a \$1.2 million increase in expenses related to the development of SNS-595, (ii) a \$1.8 million increase in expense related to the development of SNS-032, adjusted for licensing fees and milestone payments, (iii) a \$5.2 million increase in expense associated with other kinase programs, and (iv) \$2.3 million increase in expense related to other programs, partially offset by a \$1.9 million decrease in expenses associated with our SNS-314 Aurora kinase programs and a \$1.4 million decrease in expense related to our BACE inhibitor research collaboration with Merck.

Research and development expense associated with SNS-595 increased from \$7.2 million in 2005 to \$8.4 million in 2006 due to increased clinical trial activity. Research and development expense associated with SNS-032, our CDK inhibitor program, increased from \$1.7 million in 2005, adjusted for licensing fees, to \$3.4 million in 2006, adjusted for a \$2.0 million milestone payment, due to increased clinical trial activity. Research and development expense associated with SNS-314, our Aurora kinase inhibitors program, decreased from \$7.1 million in 2005 to \$5.2 million in 2006 due to a reduced number of research employees working on this program partially offset by increased outside services expense related to toxicology studies. Research and development expense for all other programs increased from \$12.2 million in 2005 to \$16.5 million in 2006 due to an increase in expense related to other kinase inhibitor programs. Research and development expense in 2006 included a \$0.9 million non-cash stock-based compensation expense due to the adoption of FAS 123R.

General and administrative expense. General and administrative expense increased from \$8.3 million in 2005 to \$12.3 million in 2006, including a \$1.2 million expense related to the adoption of FAS 123R in 2006. The increase is primarily due to (i) a \$780,000 increase in employee related expenses, and a \$859,000 increase in non-cash stock-based compensation expense, (ii) a \$1.5 million increase in professional services expenses including expenses related to managing our intellectual property portfolio and management's testing of internal control for financial reporting, and (iii) a \$798,000 increase in other expenses, including costs for directors and officers' liability insurance and facilities costs.

Interest income and expense. Interest income increased from \$1.1 million in 2005 to \$3.4 million in 2006, primarily due to higher interest rates and higher average balances of cash, cash equivalents and marketable securities. Interest expense decreased from \$674,000 in 2005 to \$478,000 in 2006, primarily due to a reduction in average debt outstanding in 2006 compared to 2005, partially offset by higher average interest rate on outstanding debt obligations in 2006 than in 2005.

Years Ended December 31, 2005 and 2004

Revenue. Revenue increased from \$10.3 million in 2004 to \$16.5 million in 2005. Collaboration revenue increased from \$10.1 million in 2004 to \$16.4 million in 2005, primarily due to a \$4.8 million increase in collaboration revenue from Biogen Idec and a \$1.4 million increase in collaboration revenue from Merck. The increase in collaboration revenue from Biogen Idec and Merck resulted from new collaborations in 2004. Grant and fellowship revenue decreased from \$166,000 in 2004 to \$109,000 in 2005, primarily due to our decision in 2003 to only perform limited additional work under SBIR grants for the foreseeable future.

Research and development expense. Research and development expense increased from \$23.6 million in 2004 to \$36.2 million in 2005, primarily due to (i) a \$9.7 million expense related to the in-license of SNS-032 in April 2005 and the subsequent development activities for this product candidate, (ii) a \$2.6 million increase in expenses related to our clinical trials of SNS-595, (iii) a \$3.4 million increase in expenses associated with our SNS-314 Aurora kinase program, and (iv) a \$4.6 million increase in expense associated with other kinase programs, partially offset by a \$4.0 million reduction in expense related to other programs.

Research and development expense associated with SNS-595 increased from \$4.6 million in 2004 to \$7.2 million in 2005. Research and development expense associated with SNS-032, our CDK inhibitor program, was \$9.7 million in 2005, including an \$8.0 million licensing fee. There were no expenses associated with this program in 2004. Research and development expense associated with SNS-314, our Aurora kinase inhibitors program, increased from \$3.7 million in 2004 to \$7.1 million in 2005. Research and development expense for all other programs decreased from \$15.3 million in 2004 to \$12.2 million in 2005.

General and administrative expense. General and administrative expense increased from \$7.4 million in 2004 to \$8.3 million in 2005, primarily due to a \$425,000 increase in non-cash stock compensation expense and a \$360,000 increase in salary and related expenses.

Interest income and expense. Interest income increased from \$518,000 in 2004 to \$1.1 million in 2005, primarily due to higher interest rates and higher average balances of cash, cash equivalents and marketable securities. Interest expense increased from \$387,000 in 2004 to \$674,000 in 2005, primarily due to a higher average interest rate on outstanding debt obligations and an increase in average debt outstanding in 2005 compared to 2004.

Income Taxes

Since inception, we have incurred operating losses and, accordingly, have not recorded a provision for income taxes for any of the periods presented. As of December 31, 2006, we had net operating loss carryforwards for federal and state income tax purposes of \$128.4 million and \$60.0 million, respectively. We also had federal research and development tax credit carryforwards of \$1.7 million. If not utilized, the federal net operating loss and tax credit carryforwards will expire beginning in 2018. Utilization of the net operating loss and tax credits carryforwards may be subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986, as amended, that are applicable if the Company experiences an "ownership change," which may occur, for example, as a result of the Company's initial public offering and other sales of the Company's stock, and similar state provisions. The annual limitation may result in the expiration of net operating losses and credits before utilization.

Liquidity and Capital Resources

Sources of Liquidity

As of December 31, 2006, we had cash, cash equivalents and marketable securities of \$63.1 million and outstanding equipment financing and debt obligations of \$1.8 million. In connection with our IPO, we issued 6,000,000 shares of common stock in September 2005 for gross proceeds of \$42.0 million and 51,126 shares of common stock in November 2005 for gross proceeds of \$357,882. After deducting the underwriters' commission and the offering expenses, we received net proceeds of approximately \$37.2 million. In March 2006, we issued common stock and warrants in a private placement resulting in gross proceeds of approximately \$45.3 million. After deducting the underwriters' commission and the offering expenses, we received net proceeds of approximately \$43.7 million. In 2006, we also received net proceeds of approximately \$653,000 from sale of equity to employees through our 2005 Employee Stock Purchase Plan and approximately \$318,000 from sale of equity under our stock option plans. Since our inception, we have funded our operations primarily through the issuance of common and preferred stock, research funding and technology access fees from our collaboration partners, research grants, loans from Biogen Idec and other debt financings.

Cash Flow

Net cash used in operating activities increased from \$10.4 million in 2004 to \$20.9 million in 2005 and to \$27.1 million in 2006. Net cash used in operating activities for these periods primarily reflects the loss for these periods, partially offset by (i) depreciation, amortization, and non-cash stock compensation expense, (ii) a \$8.0 million milestone payment related to the in-license of SNS-032 in 2005 and a \$2.0 million milestone payment related to SNS-032 in 2006. In addition, changes in deferred revenue increased cash used in operations in both 2005 and 2006 and offset cash used in operations in 2004.

Net cash used in investing activities was \$28.7 million, \$3.0 million, and \$7.1 million in the years ended December 31, 2006, 2005, and 2004, respectively. Net cash used in investing activities for 2006 primarily reflects net purchases of marketable securities of \$26.4 million and capital expenditure of \$2.3 million. Net cash used in investing activities for 2005 primarily reflects net purchases of marketable securities of \$1.4 million and capital expenditure of \$1.7 million. Net cash used in investing activities for 2004 primarily reflects net purchases of marketable securities of \$5.9 million and capital expenditure of \$1.2 million.

Net cash provided by financing activities was \$44.1 million in 2006, as compared to \$34.1 million in 2005. The net cash provided by financing activities in 2006 primarily resulted from net proceeds of \$43.7 million from the private placement of common stock and warrants completed in March 2006 and the \$971,000 in net proceeds from the sale of common stock to employees, offset by the net payments of \$533,000 on equipment loans. The net cash provided by financing activities in 2005 primarily resulted from net proceeds of \$37.4 million from the public offering of common stock completed in September 2005, offset by the payments of \$5.4 million on note payable and equipment loans. Net cash provided by financing activities was \$14.6 million in 2004, which primarily resulted from the issuance of preferred stock and indebtedness incurred under our collaboration with Biogen Idec.

Credit and Loan Arrangements

In June 2000, we entered into an equipment financing agreement with General Electric Capital Corporation, which has been amended from time to time. The credit facility was available through May 2005. As of June 30, 2005, we had outstanding \$2.3 million to finance equipment purchases and leasehold improvements. In August 2005, we entered into a new \$2.5 million credit facility with General Electric Capital Corporation and this credit facility was available through February 4, 2007. The equipment loans are secured by the equipment financed. Outstanding borrowings bear interest at annual rates ranging from 7.4% to 10.61%, and are payable over 36 to 48 months. In connection with the original credit facility,

we issued in June 2003 a warrant to purchase shares of Series C-1 preferred stock, which was converted into a warrant to purchase 1,582 shares of common stock at an exercise price per share of \$9.10 upon our IPO, and in June 2004, a warrant to purchase shares of Series C preferred stock, which was converted to a warrant to purchase 757 shares of common stock at an exercise price per share of \$9.10 upon our IPO. The warrants expire in June 2013 and June 2014,

respectively. In connection with the credit facility in August 2005, we issued a warrant to purchase 1,046 shares of common stock at an exercise price per share of \$9.10. As of December 31, 2006, the outstanding balance under this debt facility was \$1.8 million.

In December 2002, we executed a promissory note in favor of Biogen Idec for an aggregate principal amount of up to \$4.0 million. Under the promissory note, we had a drawdown period of ten calendar quarters beginning on April 1, 2003 and ending on June 30, 2005. The principal and accrued interest of each draw were due five years from the date of advance of each draw and bear interest at 3.0% above LIBOR to be paid quarterly. As of June 30, 2005, we had drawn \$4.0 million and the facility was fully drawn. We used a portion of our net proceeds from our initial public offering to repay our outstanding indebtedness to Biogen Idec in full.

In August 2005, we entered into a Venture Loan and Security Agreement with Oxford Finance Corporation and Horizon Technology Funding Company LLC, pursuant to which we may borrow up to \$15.0 million. The full \$15.0 million loan commitment was available until October 15, 2005; \$10.0 million was available until January 31, 2006, and the remaining \$5.0 million was available until May 31, 2006. We had not borrowed any monies under this loan facility and this facility has expired. In conjunction with this transaction, we issued warrants to the lenders to purchase 164,830 shares of common stock at a price of \$9.10 per share, half of which are currently exercisable. None of the remaining warrants will vest or become exercisable. We also granted the lenders registration rights under our Eighth Amended and Restated Investor Rights Agreement.

Operating Capital and Capital Expenditure Requirements

We expect to continue to incur substantial operating losses in the future. We will not receive any product revenue until a product candidate has been approved by the FDA or similar regulatory agencies in other countries and successfully commercialized. We currently anticipate that our cash, cash equivalents, marketable securities and available credit facilities, together with revenue generated from our collaborations, will be sufficient to fund our operations at least through the middle of 2008. However, we will need to raise substantial additional funds to continue our operations and bring future products to market. We cannot be certain that any of our programs will be successful or that we will be able to raise sufficient funds to complete the development and commercialize any of our product candidates currently in development, should they succeed. Additionally, we plan to continue to evaluate in-licensing and acquisition opportunities to gain access to new drugs or drug targets that would fit with our strategy. Any such transaction would likely increase our funding needs in the future.

Our future funding requirements will depend on many factors, including but not limited to:

- the rate of progress and cost of our clinical trials, preclinical studies and other discovery and research and development activities;
- the costs associated with establishing manufacturing and commercialization capabilities;
- the costs of acquiring or investing in businesses, product candidates and technologies;
- the costs of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights;
- the costs and timing of seeking and obtaining FDA and other regulatory approvals;
- the effect of competing technological and market developments; and

- the economic and other terms and timing of any collaboration, licensing or other arrangements into which we may enter.

Until we can generate a sufficient amount of product revenue to finance our cash requirements, which we may never do, we expect to finance future cash needs primarily through public or private equity offerings, debt financings or strategic collaborations. We do not know whether additional funding will be available on acceptable terms, or at all. If we are not able to secure additional funding when needed, we may have to delay, reduce the scope of or eliminate one or more of our clinical trials or research and development programs. In addition, we may have to partner one or more of our product candidate programs at an earlier stage of development, which would lower the economic value of those programs to our company.

Contractual Obligations

The following table discloses aggregate information about our contractual obligations and the periods in which payments are due as of December 31, 2006 (in thousands):

	Payment Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 years
Equipment financing	\$ 1,841	\$ 885	\$ 915	\$ 41	\$ —
Operating lease obligations	22,024	3,009	6,596	6,989	5,430
Total	\$ 23,865	\$ 3,894	\$ 7,511	\$ 7,030	\$ 5,430

The contractual summary above reflects only payment obligations that are fixed and determinable. We have additional contractual payments obligations that are contingent on future events. Our operating lease obligations relate to the lease for our two headquarters facilities in South San Francisco, California.

In December 2006, we leased approximately 15,000 square feet of additional office space in a building near to our main office in South San Francisco, California. This lease expires in April 2013, subject to our option to extend the lease through February 2014. The lease provides for \$210,000 in lease payments in 2007, \$744,000 in 2008 and 2009, \$781,000 in 2010 and 2011, and \$540,000 thereafter.

We also have agreements with clinical sites, and contract research organizations for the conduct of our clinical trials. We make payments to these sites and organizations based upon the number of patients enrolled and the period of follow-up in the trials.

Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board, or FASB, issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" ("FIN 48"). Under FIN 48 a company would recognize the benefit from a tax position only if it is more-likely-than-not that the position would be sustained upon audit based solely on the technical merits of the tax position. FIN 48 clarifies how a company would measure the income tax benefits from the tax positions that are recognized, provides guidance as to the timing of the derecognition of previously recognized tax benefits and describes the methods for classifying and disclosing the liabilities within the financial statements for any unrecognized tax benefits. FIN 48 also addresses when a company should record interest and penalties related to tax positions and how the interest and penalties may be classified within the

income statement and presented in the balance sheet. FIN 48 is effective for fiscal years beginning after December 15, 2006 and is required to be adopted by the Company effective January 1, 2007. The cumulative effects, if any, of applying FIN 48 will be recorded as an adjustment to accumulated deficit as of the beginning of the period of adoption. The Company is currently evaluating FIN 48 and its possible impacts on the Company's financial statements and is not yet in a position to determine such effects, if any.

In September 2006, the SEC issued Staff Accounting Bulletin, or SAB, No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB No. 108 provides guidance on how prior year misstatements should be taken into consideration when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. SAB No. 108 is effective for fiscal years ending on or after November 15, 2006. The adoption of SAB No. 108 did not have material impact on our financial position or results of operations for the year ended December 31, 2006.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, including structured finance, special purpose or variable interest entities.

ITEM 7A: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The primary objective of our investment activities is to preserve our capital for the purpose of funding operations while at the same time maximizing the income we receive from our investments without significantly increasing risk. To achieve these objectives, our investment policy allows us to maintain a portfolio of cash equivalents and short-term investments in a variety of securities, including commercial paper, money market funds and corporate debt securities. Our cash and cash equivalents as of December 31, 2006 included liquid money market accounts. Our marketable securities as of December 31, 2006 included readily marketable debt securities. Due to the short-term nature of these instruments, a 1% movement in market interest rates would not have a significant impact on the total value of our portfolio as of December 31, 2006.

The following table summarizes the expected maturity and average interest rate of our marketable securities at December 31, 2006:

	Year Ending December 31, 2007	Thereafter	Total Fair Value at December 31, 2006
Marketable securities	57,029,199	—	57,029,199
Average interest rate	5.35%	—	

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Sunesis Pharmaceuticals, Inc.

We have audited the accompanying balance sheets of Sunesis Pharmaceuticals, Inc. as of December 31, 2006 and 2005, and the related statements of operations, convertible preferred stock and stockholders' equity (deficit), and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Sunesis Pharmaceuticals, Inc. at December 31, 2006 and 2005, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the financial statements, in 2006 Sunesis Pharmaceuticals, Inc. changed its method of accounting for share-based compensation in accordance with guidance provided in Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment".

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Sunesis Pharmaceuticals, Inc.'s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 9, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG, LLP

San Jose, California
March 9, 2007

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SUNESIS PHARMACEUTICALS, INC.
BALANCE SHEETS

	December 31,	
	2006	2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 6,075,449	\$ 17,704,465
Marketable securities	57,029,199	30,629,061
Prepays and other current assets	1,082,817	2,068,195
Total current assets	64,187,465	50,401,721
Property and equipment, net	4,728,929	4,006,527
Deposits and other assets	359,974	300,000
Total assets	<u>\$ 69,276,368</u>	<u>\$ 54,708,248</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 2,477,656	\$ 2,044,571
Accrued compensation	2,323,742	2,067,769
Other accrued liabilities	961,766	1,277,595
Current portion of deferred revenue	2,260,478	3,787,453
Current portion of equipment financing	885,273	1,067,520
Total current liabilities	8,908,915	10,244,908
Non current portion of deferred revenue	1,143,159	3,319,765
Non current portion of equipment financing	955,695	1,306,027
Deferred rent and other non-current liabilities	1,464,902	1,371,346
Commitments		
Stockholders' equity:		
Preferred stock, \$0.0001 par value; 5,000,000 shares authorized, no shares issued and outstanding at December 31, 2006 and 2005	—	—
Common stock, \$0.0001 par value; 100,000,000 shares authorized, 29,443,079 shares issued and outstanding at December 31, 2006; 100,000,000 shares authorized, 21,514,007 shares issued and 21,511,126 shares outstanding at December 31, 2005	2,944	2,151
Additional paid-in capital	298,073,896	249,689,714
Deferred stock compensation	(1,006,604)	(2,162,688)
Accumulated other comprehensive loss	(21,376)	(55,073)
Accumulated deficit	(240,245,163)	(209,007,902)
Total stockholders' equity	56,803,697	38,466,202
Total liabilities and stockholders' equity	<u>\$ 69,276,368</u>	<u>\$ 54,708,248</u>

See accompanying notes to financial statements.

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SUNESIS PHARMACEUTICALS, INC.
STATEMENTS OF OPERATIONS

	Year Ended December 31,		
	2006	2005	2004
Revenue:			
Collaboration revenue	\$ 6,353,585	\$ 7,394,754	\$ 5,937,641
Collaboration revenue from related party	7,317,700	9,018,442	4,201,017

Grant and fellowship revenue	37,901	108,654	166,331
Total revenues	13,709,186	16,521,850	10,304,989
Operating expenses:			
Research and development	35,615,536	36,165,731	23,615,551
General and administrative	12,254,892	8,283,191	7,352,220
Total operating expenses	47,870,428	44,448,922	30,967,771
Loss from operations	(34,161,242)	(27,927,072)	(20,662,782)
Interest income	3,394,751	1,092,254	517,645
Interest expense	(477,643)	(674,163)	(386,749)
Other income, net	6,873	10,024	1,686
Net loss	(31,237,261)	(27,498,957)	(20,530,200)
Convertible preferred stock deemed dividend	—	(88,092,302)	—
Loss applicable to common stockholders	<u>\$ (31,237,261)</u>	<u>\$ (115,591,259)</u>	<u>\$ (20,530,200)</u>
Basic and diluted loss per share applicable to common stockholders	<u>\$ (1.13)</u>	<u>\$ (17.41)</u>	<u>\$ (15.77)</u>
Shares used in computing basic and diluted loss per share applicable to common stockholders	<u>27,758,348</u>	<u>6,637,935</u>	<u>1,302,096</u>

See accompanying notes to financial statements.

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SUNESIS PHARMACEUTICALS, INC.
STATEMENTS OF CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY (DEFICIT)

	Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Notes Receivable from Stockholders	Deferred Stock Compensation	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount						
Balance at December 31, 2003	7,807,145	\$ 94,821,469	1,280,595	\$ 128	\$ 2,722,757	\$ (225,000)	\$ —	\$ 12,656	\$ (72,886,443)	\$ (70,375,902)
Issuance of common stock pursuant to stock options exercises at \$0.43 to \$2.55 per share for cash, net of unvested stock options exercised early	—	—	109,563	11	233,152	—	—	—	—	233,163
Deferred stock compensation related to employee stock option grants, net of cancellations	—	—	—	—	3,339,691	—	(3,339,691)	—	—	424,018
Amortization deferred stock compensation	—	—	—	—	—	—	424,018	—	—	194,474
Expenses related to fair value of options granted to non-employees	—	—	—	—	194,474	—	—	—	—	3,304
Issuance of warrant to purchase preferred stock in connection with financing arrangement	—	—	—	—	3,304	—	—	—	—	—
Issuance of Series C-2 convertible preferred stock to investors at \$17.95 per share for cash in September 2004, net of issuance costs of \$8,850	779,858	13,991,150	—	—	—	—	—	—	—	—
Repayment of stockholder note in April 2004	—	—	—	—	—	90,000	—	—	—	90,000
Components of comprehensive loss:	—	—	—	—	—	—	—	—	—	—
Net loss	—	—	—	—	—	—	—	—	(20,530,200)	(20,530,200)
Unrealized loss on investments	—	—	—	—	—	—	—	(82,426)	—	(82,426)
Comprehensive loss	—	—	—	—	—	—	—	(82,426)	—	(20,612,626)
Balance at December 31, 2004	8,587,003	108,812,619	1,390,158	139	6,493,378	(135,000)	(2,915,673)	(69,770)	(93,416,643)	(90,043,569)
Issuance of common stock pursuant to stock options exercises at \$1.28 to \$9.56 per share, including vesting of stock options exercised early	—	—	41,940	4	108,681	—	—	—	—	108,685
Expense related to fair value of restricted stock award granted to non-employee	—	—	666	—	3,438	—	—	—	—	3,438
Deferred stock compensation related to employee stock option grants	—	—	—	—	293,125	—	(293,125)	—	—	—
Amortization deferred stock compensation	—	—	—	—	—	—	962,907	—	—	962,907
Expenses related to accelerated vesting of officers' stock option grant	—	—	—	—	21,000	—	83,203	—	—	104,203
Expenses related to fair value of options granted to non-employees	—	—	—	—	196,370	—	—	—	—	196,370
Issuance of Series C-2 convertible preferred stock to BMS at \$17.95 per share in connection with in-licensing arrangement in April 2005	445,633	8,000,000	—	—	—	—	—	—	—	—
Issuance of common stock to preferred stockholders in connection with the Company's initial public offering in September, 2005	(9,032,636)	(116,812,619)	9,032,636	903	116,811,716	—	—	—	—	116,812,619
Issuance of common stock to investors at \$7.00 per share for cash in September 2005, net of issuance costs of \$2,225,322	—	—	6,051,126	605	37,166,904	—	—	—	—	37,167,509
Payment of deemed dividend in common stock	—	—	4,994,600	500	88,091,802	—	—	—	—	88,092,302
Issuance of warrant to purchase preferred stock in connection with financing arrangement	—	—	—	—	503,300	—	—	—	—	503,300
Repayment of stockholder note in April 2005	—	—	—	—	—	135,000	—	—	—	135,000
Components of comprehensive loss:	—	—	—	—	—	—	—	—	—	—
Net loss applicable to common stockholders	—	—	—	—	—	—	—	—	(115,591,259)	(115,591,259)
Unrealized gain on investments	—	—	—	—	—	—	—	14,697	—	14,697
Comprehensive loss	—	—	—	—	—	—	—	14,697	—	(115,576,562)
Balance at December 31, 2005	—	—	21,511,126	2,151	249,689,714	—	(2,162,688)	(55,073)	(209,007,902)	38,466,202
Issuance of common stock pursuant to stock options exercises at \$1.28 to \$5.25 per share, including vesting of stock options exercised early	—	—	126,844	13	318,143	—	—	—	—	318,156
Expense related to fair value of restricted stock award granted to non-employee	—	—	2,001	—	11,367	—	—	—	—	11,367
Reversal of deferred stock compensation related to employee stock option grants	—	—	—	—	(432,872)	—	432,872	—	—	—
Amortization deferred stock compensation	—	—	—	—	—	—	723,212	—	—	723,212
Stock-based compensation expenses related to fair value of options granted to non-employees	—	—	—	—	100,470	—	—	—	—	100,470
Stock-based compensation expenses related to fair value of options granted to employees	—	—	—	—	2,046,655	—	—	—	—	2,046,655
Issuance of common stock for Employee Stock Purchase Program	—	—	145,632	14	652,918	—	—	—	—	652,932
Issuance of common stock to BMS at \$4.95 per share in connection with in-licensing arrangement	—	—	404,040	41	1,999,958	—	—	—	—	1,999,999
Issuance of common stock to investors at \$6.21 per share for cash in March, 2006, net of issuance costs of \$1,613,471	—	—	7,246,377	725	43,657,543	—	—	—	—	43,658,268
Issuance of common stock pursuant to warrant exercise at \$4.25 per share	—	—	7,059	—	30,000	—	—	—	—	30,000
Components of comprehensive loss:	—	—	—	—	—	—	—	—	—	—
Net loss	—	—	—	—	—	—	—	—	(31,237,261)	(31,237,261)
Unrealized gain on investments	—	—	—	—	—	—	—	33,697	—	33,697
Comprehensive loss	—	—	—	—	—	—	—	33,697	—	(31,203,564)
Balance at December 31, 2006	—	\$ —	29,443,079	\$ 2,944	\$ 298,073,896	\$ —	\$ (1,006,604)	\$ (21,376)	\$ (240,245,163)	\$ 56,803,697

See accompanying notes.

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SUNESIS PHARMACEUTICALS, INC.
STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2006	2005	2004
Cash flows from operating activities			
Net loss	\$ (31,237,261)	\$ (27,498,957)	\$ (20,530,200)
Adjustments to reconcile loss to net cash used in operating activities:			
Depreciation and amortization	1,582,315	1,683,821	2,170,808
Stock compensation expense	2,881,704	1,266,918	618,492
Non-cash research and development expense	1,999,999	8,000,000	—

Changes in operating assets and liabilities:			
Prepaids and other current assets	985,378	110,644	(747,696)
Notes and interest receivable from officers and employees	—	163,720	(882)
Deposits and other assets	(59,974)	—	—
Accounts payable	433,085	382,036	681,874
Accrued compensation	255,973	468,552	342,538
Other accrued liabilities	(315,829)	904,953	264,333
Deferred rent and other non-current liabilities	93,556	175,058	253,894
Deferred revenue	(3,703,581)	(6,602,482)	6,536,623
Net cash used in operating activities	(27,084,635)	(20,945,737)	(10,410,216)
Cash flows from investing activities			
Purchases of property and equipment, net	(2,304,717)	(1,702,356)	(1,169,577)
Purchases of marketable securities	(68,035,554)	(36,577,611)	(35,264,682)
Maturities of marketable securities	41,669,113	35,187,756	29,323,129
Repayment of note receivable from officers and employees	—	85,350	—
Proceeds from sale of property and equipment	—	1,365	—
Net cash used in investing activities	(28,671,158)	(3,005,496)	(7,111,130)
Cash flows from financing activities			
Proceeds from borrowings under debt facility with related party	—	800,000	1,600,000
Repayment of borrowings under debt facility with related party	—	(4,000,000)	—
Proceeds from borrowings under note payable and equipment financing	563,132	1,273,180	935,036
Payments on note payable and equipment financing	(1,095,711)	(1,429,426)	(2,223,483)
Proceeds from issuance of common stock and exercise of options, net of repurchases	44,659,356	37,424,432	328,652
Proceeds from issuance of convertible preferred stock, net of issuance costs	—	—	13,991,150
Net cash provided by financing activities	44,126,777	34,068,186	14,631,355
Net increase (decrease) in cash and cash equivalents	(11,629,016)	10,116,953	(2,889,991)
Cash and cash equivalents at beginning of period	17,704,465	7,587,512	10,477,503
Cash and cash equivalents at end of period	\$ 6,075,449	\$ 17,704,465	\$ 7,587,512
Supplemental disclosure of cash flow information			
Interest paid	\$ 224,992	\$ 674,163	\$ 386,749
Non-cash activities:			
Conversion of convertible preferred stock to common stock upon initial public offering	\$ —	\$ 116,812,619	\$ —
Deferred stock-based compensation, net of (reversal)	\$ (432,872)	\$ 293,125	\$ 3,339,691
Issuance of warrants for financing arrangement	\$ —	\$ 503,300	\$ 3,304
Convertible preferred stock deemed dividend	\$ —	\$ 88,092,302	\$ —

See accompanying notes to financial statements.

SUNESIS PHARMACEUTICALS, INC.
NOTES TO FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies

Organization

Sunesis Pharmaceuticals, Inc. (the “Company”) was incorporated in the state of Delaware on February 10, 1998, and its facilities are located in South San Francisco, California. Sunesis is a clinical-stage biopharmaceutical company focused on discovering, developing and commercializing novel small molecule therapeutics for oncology and other unmet medical needs. The Company’s primary activities since incorporation have been conducting research and development internally and through corporate collaborators, in-licensing pharmaceutical compounds, performing business and financial planning, and raising capital.

Need to Raise Additional Capital

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. The Company has incurred significant losses and negative cash flows from operations since its inception. At December 31, 2006, the Company had an accumulated deficit of \$240,245,163. Management believes that currently available cash, cash equivalents and marketable securities together with amounts available to be borrowed under existing financing agreements (see Note 8) will provide sufficient funds to enable the Company to meet its obligations through at least the middle of 2008. Management plans to continue to finance the Company’s operations with a combination of equity issuances, debt arrangements, and revenues from collaborations with pharmaceutical companies, technology licenses, and in the longer term, product sales and royalties. If adequate funds are not available, the Company may be required to delay, reduce the scope of, or eliminate one or more of its development programs or obtain funds through collaborative arrangements with others that may require the Company to relinquish rights to certain of its technologies, product candidates, or products that the Company would otherwise seek to develop or commercialize itself. The Company intends to raise additional funds through the issuance of equity securities, if available on terms acceptable to the Company.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ materially from these estimates.

Clinical Trials Accounting

All of the Company's clinical trials are performed by contract research organizations, or CROs, and participating clinical trials sites. Some CROs bill monthly for services performed, and others bill based upon milestones achieved. For the latter, the Company accrues clinical trial expenses based on the services performed each period. Costs of setting up clinical trial sites for participation in the trials are expensed immediately as research and development expenses. Clinical trial site costs related to patient enrollment are accrued as patients are entered into the trial reduced by any initial payment made to the clinical trial site when the first patient is enrolled.

Cash Equivalents and Marketable Securities

The Company considers all highly liquid securities with original maturities of three months or less from the original date of purchase to be cash equivalents, which consist of money market funds and corporate debt securities. Marketable securities consist of securities with original maturities greater than three months, and consist of money market funds, corporate debt securities and U.S. government obligations.

Management determines the appropriate classification of securities at the time of purchase. The Company has classified its entire investment portfolio as available-for-sale. The Company views its available-for-sale portfolio as available for use in current operations. Accordingly, the Company has classified all investments as short-term, even though the stated maturity may be one year or more beyond the current balance sheet date. Available-for-sale securities are carried at fair value with unrealized gains and losses reported in accumulated other comprehensive income (loss) as a separate component of stockholders' equity (deficit). The estimated fair values have been determined by the Company using available market information.

The amortized cost of securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in interest income. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities, if any, are recorded in other income (expense), net. There were no material realized gains or losses in the periods presented. The cost of securities sold is based on the specific-identification methods. Interest and dividends are included in interest income.

Concentrations of Credit Risk and Financial Instruments

The Company invests cash that is not currently being used for operational purposes in accordance with its investment policy. The policy allows for the purchase of low risk debt securities issued by U.S. government agencies and very highly rated banks and corporations, subject to certain concentration limits. The maturities of these securities are maintained at no longer than 18 months. The Company believes its established guidelines for investment of its excess cash maintain safety and liquidity through its policies on diversification and investment maturity.

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents, available-for-sale marketable securities, and borrowings under debt facilities. The carrying amounts of cash equivalents and available-for-sale marketable securities approximate fair value due to their short-term nature. The carrying amounts of borrowings under the Company's debt facilities approximate fair value based on the current interest rates for similar borrowing arrangements.

The Company is exposed to credit risk in the event of default by the institutions holding the cash, cash equivalents, and available-for-sale securities to the extent of the amounts recorded on the balance sheets.

Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation is determined using the straight-line method over the estimated useful lives of the respective assets, generally three to five years. Leasehold improvements are amortized on a straight-line basis over the shorter of their estimated useful lives or the term of the lease.

Stock-Based Payments

The Company grant options to purchase common stock to its employees, directors and consultants under its stock option plans. Eligible employees can also purchase shares of common stock at 85% of the

lower of the fair market value of the common stock at the beginning of an offering period or at the purchase date.

The Company account for stock compensation arrangements to non-employees in accordance with EITF No. 96-18, *Accounting for Equity Instruments That Are Issued to Other than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*, using a fair value approach. The compensation costs of these arrangements are subject to remeasurement over the vesting terms as earned.

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "*Share-Based Payment*" ("FAS 123R"), which supersedes its previous accounting under APB Opinion No. 25, "*Accounting for Stock Issued to Employees*" ("APB 25"). Under FAS 123R, share-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as expense over the employee's requisite service period. The Company has no awards with market or performance conditions. The Company adopted the provisions of FAS 123R using the modified prospective transition method for awards granted on or after December 23, 2004, the date on which the Company filed its initial registration statement on Form S-1 with the Securities and Exchange Commission ("SEC") in connection with its IPO. The prospective transition method has been applied to options granted prior to December 23, 2004. Under the modified prospective transition method, compensation cost recognized during the twelve months ended December 31, 2006, includes: (a) compensation cost for all share-based payments granted subsequent to the initial filing of the Company's Form S-1 on December 23, 2004, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123 (as defined below) and amortized on a straight-line basis over the options' vesting period; and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of FAS 123R amortized on a straight-line basis over the options' vesting period. Under the prospective transition method, options granted prior to the initial filing of the Company's Form S-1 will continue to be accounted for in accordance with APB 25 and Financial Accounting Standards Board ("FASB") Interpretation No. 44 ("FIN 44"), *Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB No. 25*, which were the accounting principles originally applied to those awards.

The valuation provisions of FAS 123R apply to new awards and to awards that are outstanding on the effective date and subsequently modified or cancelled. Estimated compensation expense for awards outstanding at the effective date will be recognized over the remaining service period using the compensation cost calculated for pro forma disclosure purposes under FASB Statement No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"). As stock-based compensation expense recognized in the Condensed Statement of Operations for fiscal 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. FAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company reviewed its forfeiture estimates on a quarterly basis during 2006. In the Company's pro forma information required under SFAS 123 for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred. The Company's Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of FAS 123R.

Upon adoption of FAS 123R, the Company retained its method of valuation for share-based awards granted beginning in fiscal 2006 with the use of the Black-Scholes option-pricing model ("Black-Scholes model") which was previously used for the Company's pro forma information required under SFAS 123. The Company's determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the Company's expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors.

FAS 123R requires the cash flows resulting from the tax benefits related to tax deductions in excess of the compensation costs recognized for these options (excess tax benefits) to be classified as financing cash flows.

On November 10, 2005, the FASB issued FASB Staff Position No. FAS 123(R)-3, "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards." The Company has elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of share-based compensation pursuant to FAS 123R. The alternative transition method includes a simplified method to establish the beginning balance of the additional paid-in capital pool related to the tax effects of employee share-based compensation, which is available to absorb tax deficiencies recognized subsequent to the adoption of FAS 123R.

Comprehensive Loss

The Company displays comprehensive loss and its components as part of the statement of convertible preferred stock and stockholders' equity (deficit). Comprehensive loss is comprised of loss and unrealized gains (losses) on available-for-sale securities.

Revenue Recognition

In accordance with Emerging Issues Task Force, EITF, 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*, which the Company adopted effective July 1, 2003, revenue arrangements with multiple deliverable items are divided into separate units of accounting if certain criteria are met, including whether the delivered item has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. The Company allocates the consideration it receives among the separate units of accounting based on their respective fair value, and applies the applicable revenue recognition criteria to each of the separate units. Where an item in a revenue arrangement with multiple deliverables does not constitute a separate unit of accounting and for which delivery has not occurred, the Company defers revenue until the delivery of the item is completed.

Upfront, non-refundable license fees and other fees received in connection with research and development collaboration are recorded as deferred revenue and recognized ratably over their relevant periods specified in the agreements, generally the research term.

Research funding related to collaborative research with the Company's collaboration partners is recognized as the related research services are performed. This funding is normally based on a specified amount per full-time equivalent employee per year.

Revenue from milestone payments, which are substantially at risk at the time the collaboration agreement is entered into and performance-based at the date of the collaboration agreement, is recognized upon completion of the applicable milestone events. Royalty revenue is recognized based on reported product sales by third-party licensees.

Grant revenues from government agencies and private research foundations are recognized as the related qualified research and development costs are incurred, up to the limit of the prior approval funding amounts.

Research and Development

All research and development costs, including those funded by third parties, are expensed as incurred. Research and development costs consist of salaries, employee benefits, laboratory supplies, costs associated with clinical trials, including amounts paid to clinical research organizations, other professional services and facility costs.

Income Taxes

The Company accounts for income taxes under the liability method. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates that will be in effect when the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Long-Lived Assets

The Company periodically assesses the impairment of long-lived assets in accordance with the provisions of SFAS No. 144 ("SFAS 144"), *Accounting for the Impairment or Disposal of Long-Lived Assets*. A review for impairment is performed whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable, such as a significant industry or economic downturn, significant changes in the manner of use of the acquired assets or the strategy for the Company's overall business. If indicators of impairment exist, recoverability is assessed by comparing the estimated undiscounted cash flows resulting from the use of the asset and its eventual disposition against its carrying amount. If the aggregate undiscounted cash flows are less than the carrying amount of the asset, the resulting impairment charge to be recorded is calculated based on the excess of the carrying value of the

asset over the fair value of such asset, with fair value determined based on an estimate of discounted future cash flows or other appropriate measure of fair value. For the years ended December 31, 2006, 2005 and 2004, no impairment charges were recorded.

Recent Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board, or FASB, issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109" ("FIN 48"). Under FIN 48 a company would recognize the benefit from a tax position only if it is more-likely-than-not that the position would be sustained upon audit based solely on the technical merits of the tax position. FIN 48 clarifies how a company would measure the income tax benefits from the tax positions that are recognized, provides guidance as to the timing of the derecognition of previously recognized tax benefits and describes the methods for classifying and disclosing the liabilities within the financial statements for any unrecognized tax benefits. FIN 48 also addresses when a company should record interest and penalties related to tax positions and how the interest and penalties may be classified within the income statement and presented in the balance sheet. FIN 48 is effective for fiscal years beginning after December 15, 2006 and is required to be adopted by the Company effective January 1, 2007. The cumulative effects, if any, of applying FIN 48 will be recorded as an adjustment to accumulated deficit as of the beginning of the period of adoption. The Company is currently evaluating FIN 48 and its possible impacts on the Company's financial statements and is not yet in a position to determine such effects, if any.

In September 2006, the SEC issued Staff Accounting Bulletin, or SAB, No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*. SAB No. 108 provides guidance on how prior year misstatements should be taken into consideration when quantifying misstatements in current year financial statements for purposes of determining whether the current year's financial statements are materially misstated. SAB No. 108 is effective for fiscal years ending on or after November 15, 2006. The adoption of SAB No. 108 did not have material impact on our financial position or results of operations for the year ended December 31, 2006.

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2. Loss Per Share

Basic loss per common share is calculated by dividing the loss applicable to common stockholders by the weighted-average number of common (per common share) shares outstanding for the period, less the weighted average unvested common shares subject to repurchase. Diluted loss per common share is computed by dividing the loss by the weighted-average number of common shares outstanding, less the weighted average unvested common shares subject to repurchase, and dilutive potential common shares for the period determined using the treasury stock method. For purpose of this calculation, preferred stock, options to purchase stock, and warrants to purchase stock are considered to be potential common shares and are only included in the calculation of diluted loss per common share when their effect is dilutive.

The following table sets forth the computation of basic and diluted loss per share applicable to common stockholders.

	Year Ended December 31,		
	2006	2005	2004
Historical Numerator:			
Loss applicable to common stockholders	\$ (31,237,261)	\$ (115,591,259)	\$ (20,530,200)
Denominator:			
Weighted-average common shares outstanding	27,758,348	6,647,516	1,332,880
Less: Weighted-average unvested common shares subject to repurchase	—	(9,581)	(30,784)
Denominator for basic and diluted loss per share applicable to common stockholders	<u>27,758,348</u>	<u>6,637,935</u>	<u>1,302,096</u>
Basic and diluted loss per share applicable to common stockholders	<u>\$ (1.13)</u>	<u>\$ (17.41)</u>	<u>\$ (15.77)</u>
Outstanding securities not included in diluted loss per share calculations			
Preferred stock	—	—	8,587,003
Options to purchase common stock	3,942,435	2,994,701	1,680,157
Warrants	2,693,237	526,382	231,088
	<u>6,635,672</u>	<u>3,521,083</u>	<u>10,498,248</u>

3. License Agreements

The Regents of the University of California

In December 1998, the Company entered into an exclusive license agreement with The Regents of the University of California (the "Regents") for rights to certain technology to identify small molecule drug leads. The agreement provides the Company with an exclusive license to develop, make, use, and sell products derived from the licensed technology, and will continue for the life of the last-to-expire patent. To date, the licensed technology has produced two issued patents, U.S. patent Nos. 6,344,330 and 6,344,334, which are both due to expire on March 27, 2018. The agreement provides for the Company to pay the Regents noncreditable, nonrefundable fees of up to \$75,000 according to a payment schedule of which \$55,000 has been paid, as well as to issue to the Regents 11,765 shares of common stock, which were issued in December 1998. The Company has agreed to achieve certain development milestones of compounds derived from the licensed technology, including initiation of preclinical testing due June 30, 2002 and initiation of clinical testing due June 30, 2004. If such milestones were not met, the Regents, upon providing written notice to the Company, could seek to either terminate the agreement or amend the exclusive license to be a nonexclusive license. Because the Company no longer uses the licensed technology

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and none of the Company's preclinical or clinical compound originates from the licensed technology, the preclinical and clinical milestones have not been met. The Company has not received written notice from the Regents to terminate or amend the agreement and the Company continues to provide the Regents

status reports of the state of the licensed technology. The Company also continues to maintain patents and patent applications that cover the licensed technology because of its belief that some aspects of the licensed technology may provide some value in the future.

Dainippon Sumitomo Pharma

In October 2003, the Company entered into an agreement with Dainippon Sumitomo Pharma Co., Ltd. (“Dainippon”) to acquire exclusive worldwide development and marketing rights for Dainippon’s anti-cancer compound, referred to as SNS-595.

Under the terms of this agreement, the Company made a non-refundable payment of \$700,000, which was included in research and development expense. In addition to payments already made as of December 31, 2006, the Company may in the future make a series of milestone payments of up to \$8.0 million to Dainippon based on successful development and regulatory approval of SNS-595 for cancer indications, as well as royalty payments based on any future product sales. In return, the Company has received an exclusive, worldwide license to develop and market SNS-595. As of December 31, 2005, the Company accrued a \$500,000 milestone payment upon commencement of Phase 2 clinical trials as research and development expense and this milestone payment was made in February 2006.

Bristol-Myers Squibb Company

In April 2005, the Company entered into an agreement with Bristol-Myers Squibb Company (“BMS”) to acquire worldwide development and commercialization rights for BMS’ anti-cancer compound, referred to as SNS-032.

Under the terms of this agreement, the Company made an up-front \$8,000,000 equity payment through the issuance of 445,663 shares of the Company’s Series C-2 preferred stock, which converted into 879,094 shares of common stock upon the Company’s IPO in September 2005. This amount was included in research and development expense for the year ended December 31, 2005 due to uncertainties surrounding the remaining efforts for completion of the research and development activities. The Company may in the future be required to make a series of milestone payments of up to \$29.0 million in cash, equity or any combination thereof to BMS based on the successful development and approval for the first indication and formulation of SNS-032. In addition, the Company may be required to make a series of development and commercialization milestone payments totaling up to \$49.0 million in cash, equity or any combination thereof, as well as royalty payments based on any future product net sales. In return, the Company received worldwide exclusive and non-exclusive diagnostic and therapeutic licenses to SNS-032 and future CDK inhibitors derived from related intellectual property. In February 2006, upon commencement of a Phase 1 clinical trial, the Company made a \$2.0 million milestone payment through the issuance of 404,040 shares of the Company’s common stock, which was recorded as R&D expense.

The University of California, San Francisco

In August 2005, and amended in April 2006, the Company entered into research and license agreements with the University of California, San Francisco, or UCSF, that allows UCSF a limited license to use Tethering® for academic purposes. UCSF intends to leverage Tethering® to identify novel, small molecule drug candidates. In return, the Company received an exclusive royalty-free license to any improvements to Tethering® or fragment libraries that emerge from UCSF’s research. In the event that any small molecules are discovered using Tethering®, the Company will have a right of first negotiation to in-license the compounds. UCSF is precluded from utilizing the technology for commercial purposes and

from conducting research in the kinase field or any other drug target on which the Company is currently interested. The research at UCSF is being conducted by Dr. James Wells. Dr. Wells was a founder of our company and is a member of our board of directors.

SARcode, Inc.

In March 2006, and amended in December 2006, the Company entered into a license agreement with SARcode, Inc., or SARcode, a privately-held biopharmaceutical company, that provides SARcode a license to our LFA-1 inhibitor program. SARcode intends to use the license to develop small molecule drugs to treat inflammatory diseases. The Company had previously discontinued the LFA-1 inhibitor program, which is outside of the Company’s strategic focus on discovering and developing novel small molecule therapeutics to treat cancer.

In conjunction with the license, in January the Company received a \$250,000 license fee, which was recorded as revenue, and a \$250,000 note convertible into preferred stock of SARcode in certain circumstances. Under the terms of the license agreement, SARcode received an exclusive, worldwide license to all of the Company’s LFA-1 patents and related know-how. In addition to cash and convertible note already received, the Company may in the future receive up to \$1.0 million in license fees and convertible notes, \$31.0 million in development and marketing milestone payments, and royalties for the commercialization of a licensed compound.

4. Collaborative Research Agreements

Johnson & Johnson Pharmaceutical Research and Development, L.L.C.

In May 2002, the Company entered into a research collaboration to discover small molecule inhibitors of Cathepsin S with Johnson & Johnson Pharmaceutical Research & Development, L.L.C. (“J&J PRD”). The Company applies its proprietary Tethering® technology to discover novel inhibitors of Cathepsin S in this collaboration.

Under the terms of the agreement, the Company received a non-refundable and non-creditable technology access fee of \$500,000 in February 2003, and certain research funding to be paid in advance quarterly. The Company may in the future receive research and development milestones of up to \$24.5 million as well as royalty payments from J&J PRD based on future product sales. On December 15, 2002, the Company and J&J PRD amended the collaboration to increase the number of J&J PRD funded full-time equivalents for 2003. In December 2002, J&J PRD also made the first milestone payment of \$250,000 to the Company for the delivery of a novel lead series of compounds. On December 15, 2003, the Company and J&J PRD again amended the collaboration to extend the research funding for one additional year from May 3, 2004 through May 2, 2005. On December 22, 2004, the Company and J&J PRD amended the collaboration to extend the research funding from May 3, 2005 until December 31, 2005. The research funding portion of the agreement expired on December 31, 2005. Costs associated with research and development activities attributable to this agreement approximate the research funding recognized.

Biogen Idec, Inc.

In December 2002, the Company entered into a research collaboration with Biogen Idec, Inc. (“Biogen Idec”) to discover oral therapeutics. The collaboration applies the Company’s proprietary Tethering® technology to generate small molecule leads to selected TNF family cytokines involved in immune and inflammatory disease and two additional un-named targets.

During the initial phase of the collaboration, both companies contributed scientists and discovery resources to the collaboration at their own cost. Under an exclusive worldwide license to compounds resulting from these efforts, Biogen Idec has the right to develop, manufacture, and commercialize compounds discovered under the collaboration.

Under the terms of the agreement, the Company received an upfront, non-refundable and non-creditable technology access fee of \$3,000,000, which is being recognized as revenue over the 30-month term of the agreement and the one-year option period. In addition, the Company started receiving quarterly maintenance fees of \$357,500 commencing April 1, 2004, and the Company may in the future receive research and development milestones of up to \$60.5 million and royalty payments based on total annual future product sales. In certain circumstances, such as the cessation of the development of particular compounds, milestone payments received may be credited against future milestone payments with respect to compounds directed to the same target as the discontinued compound. As such, the Company recognizes the milestones received as revenue ratably over the remaining term of the agreement. On June 18, 2005, the one-year option was not exercised by Biogen Idec and the research term of this agreement was completed. Accordingly, the remaining deferred revenue of \$824,872 was recognized in the second quarter of 2005.

Concurrent with the signing of the agreement, Biogen Idec made a \$6,000,000 equity investment and purchased shares of the Company's Series C-1 preferred stock. Biogen Idec had also agreed to loan the Company up to \$4,000,000 with a drawdown period of ten calendar quarters beginning on January 1, 2003 and ending on June 30, 2005. The principal and accrued interest of each draw is due five years from the date of advance of each draw and bear interest at three percent above LIBOR (LIBOR was 1.46% at December 31, 2003, and 3.10% at December 31, 2004) to be paid quarterly. As of December 31, 2003 and 2004 and September 30, 2005, the Company had drawn \$1,600,000, \$3,200,000 and \$4,000,000, respectively, with \$2,400,000, \$800,000 and none, respectively, available for future draws. On September 30, 2005, this loan was repaid in full with interest.

On August 27, 2004, the Company entered into the second research collaboration with Biogen Idec to discover and develop small molecules targeting kinases, a family of cell signaling enzymes that play a role in the progression of cancer. The Company applies its proprietary Tethering® technology to generate novel small molecule leads that inhibit the oncology kinase targets that are covered by this collaboration.

One of the kinase targets in the collaboration is Raf, and the Company's Raf program was folded into the collaboration. Under the terms of the agreement, the Company received a \$7,000,000 upfront nonrefundable and noncreditable technology access fee, which is being recognized as revenue over an initial four-year research term. In the event that Biogen Idec decides to exercise its option to extend the initial four-year research term for one additional year, Biogen Idec is obligated to pay to the Company an additional technology access fee specified in the agreement. In addition, the Company is obligated to receive quarterly research funding of \$1.2 million, subject to inflation adjustments, to be paid in advance to support some of its scientific personnel, and the Company may in the future receive pre-commercialization milestone payments of up to \$60.5 million and royalty payments based on any product sales. The Company retains an option to participate in the co-development and co-promotion of product candidates for up to two targets that may emerge from this collaboration. In April 2006, the Company received a \$500,000 milestone payment from Biogen Idec for meeting certain preclinical milestone related to Raf program, and the Company recorded it as revenue.

Concurrent with the signing of the agreement, Biogen Idec made a \$14,000,000 equity investment by purchasing shares of the Company's Series C-2 preferred stock.

Merck & Co., Inc.

In February 2003, the Company and Merck & Co., Inc. ("Merck"), entered into a research collaboration to identify and optimize inhibitors of BACE, an Alzheimer's disease target. This collaboration had an initial three-year research term and a one-year option period. In November 2005, the one-year option was not exercised by Merck and the research term of the collaboration ended in February 2006. Accordingly, the upfront, non-refundable and non-creditable technology access fee was

recognized as revenue over the 36-month term of the agreement ending February 2006. However, the Company retains the right to earn milestone payments and royalties on any compound that results from the collaboration. In June 2006, the Company received a \$4.25 milestone payment from Merck for meeting certain preclinical milestones related to BACE.

On July 22, 2004, the Company and Merck entered into a multi-year research collaboration to discover novel oral drugs for the treatment of viral infections. The Company provided Merck with a series of small molecule compounds targeting viral infections. These compounds were derived from Tethering®. Merck agreed to be responsible for advancing these compounds into lead optimization, preclinical development, and clinical studies. Merck is obligated to pay annual license fees for the Company's consulting services and ongoing access to Tethering® as a means of identifying additional compounds for the treatment of viral infections.

Under the terms of the agreement, the Company received an upfront, nonrefundable and noncreditable technology access fee of \$2.3 million, which is being recognized as revenue over an initial three-year research term, is entitled to receive annual license fees aggregating \$950,000 and may receive payments based on the achievement of development milestones of up to \$22.1 million. In addition, the Company is entitled to receive royalty payments based on net sales for any products resulting from the collaboration. Merck receives an exclusive worldwide license to any products resulting from the collaboration.

In connection with the above collaboration agreements, the Company recognized the following revenues, which include the amortization of upfront fees received, research funding, and milestones earned:

	Year Ended December 31,		
	2006	2005	2004
J&J PRD	\$ —	\$ 1,417,557	\$ 1,334,333
Merck	6,353,585	5,977,197	4,603,308
	6,353,585	7,394,754	5,937,641
Biogen Idec—related party	7,317,700	9,018,442	4,201,017
	<u>\$ 13,671,285</u>	<u>\$ 16,413,196</u>	<u>\$ 10,138,658</u>

5. Marketable Securities

The following is a summary of available-for-sale securities:

December 31, 2006	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Money market funds	\$ 5,726,040	\$ —	\$ —	\$ 5,726,040
Corporate debt obligations	4,056,014	110	(460)	4,055,664
Commercial paper	52,994,561	10,216	(31,242)	52,973,535
Total	62,776,615	10,326	(31,702)	62,755,239
Less amounts classified as cash equivalents	(5,726,040)	—	—	(5,726,040)
Total marketable securities	<u>\$ 57,050,575</u>	<u>\$ 10,326</u>	<u>\$ (31,702)</u>	<u>\$ 57,029,199</u>
December 31, 2005	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Money market funds	\$ 11,598,501	\$ —	\$ —	\$ 11,598,501
Corporate debt obligations	30,194,738	—	(60,067)	30,134,671
Commercial paper	6,456,096	4,994	—	6,461,090
Total	48,249,335	4,994	(60,067)	48,194,262
Less amounts classified as cash equivalents	(17,560,906)	(4,295)	—	(17,565,201)
Total marketable securities	<u>\$ 30,688,429</u>	<u>\$ 699</u>	<u>\$ (60,067)</u>	<u>\$ 30,629,061</u>

There were no realized gains or losses on the sale of available-for-sale securities for the years ended December 31, 2006 and 2005.

At December 31, 2006 and 2005, the contractual maturities of marketable securities were as follows:

	December 31, 2006		December 31, 2005	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 57,050,575	\$ 57,029,199	\$ 30,688,429	\$ 30,629,061
Due in more than one year	—	—	—	—
Total	<u>\$ 57,050,575</u>	<u>\$ 57,029,199</u>	<u>\$ 30,688,429</u>	<u>\$ 30,629,061</u>

6. Property and Equipment

Property and equipment at December 31 consist of the following:

	2006	2005
Computer equipment and software	\$ 3,208,357	\$ 2,629,673
Furniture and office equipment	762,421	625,081
Laboratory equipment	9,437,313	8,343,087
Leasehold improvements	5,387,595	5,121,873
	18,795,686	16,719,714
Less accumulated depreciation and amortization	(14,066,757)	(12,713,187)
Net property and equipment	<u>\$ 4,728,929</u>	<u>\$ 4,006,527</u>

Equipment purchased under equipment financing agreements (see Note 8) is included in property and equipment. At December 31, 2006 and 2005, financed equipment had a cost basis of \$4,377,428 and \$5,626,822, respectively, with accumulated depreciation of \$2,567,265 and \$3,385,224, respectively.

7. Other Accrued Liabilities

Other accrued liabilities at December 31 are as follows:

	2006	2005
Accrued professional services	\$ 313,085	\$ 212,033
Tax payable	43,300	27,408
Accrued clinical expense	605,381	1,038,154
Total	<u>\$ 961,766</u>	<u>\$ 1,277,595</u>

8. Equipment Financing and Debt Facility

In June 2000, the Company entered into an equipment financing agreement with General Electric Capital Corporation, which has been amended from time to time. The credit facility was available through May 2005. In August 2005 the Company entered into a new \$2.5 million credit facility with the same financing company. The Company can borrow under this facility to finance capital equipment purchases until February 4, 2007. The equipment loans are secured by the equipment financed.

In conjunction with this new credit facility, the Company issued warrants to the financing company to purchase shares of the Series C preferred stock, which converted into warrants to purchase 1,046 shares of common stock in connection with the IPO. The fair values of the warrant issued is \$4,862, as

determined using the Black-Scholes options pricing model, and is being accounted for as prepaid interest and expensed on a straight-line basis over the term of the agreement. This prepaid interest was fully amortized as of December 31, 2006

As of December 31, 2006 and 2005, the Company had drawn \$9,235,594 and \$8,672,462, respectively, to finance equipment purchases and leasehold improvements and had \$1,124,946 and \$1,688,078, respectively, available under the facility. Outstanding borrowings bear interest at rates ranging from 7.4% to 10.61% as of December 31, 2006, and are to be paid over 36 to 48 months. Outstanding borrowings bear interest at rates ranging from 7.4% to 9.89% as of December 31, 2005, and are to be paid over 36 to 48 months.

As of December 31, 2006 and 2005, the Company was in compliance with all the covenants in these loan agreements.

In December 2002, the Company executed a promissory note in favor of Biogen Idec for an aggregate principal amount of up to \$4.0 million. Pursuant to the collaboration agreement with Biogen Idec, in 2005 the Company had drawn \$4,000,000 under a facility loan agreement. As of December 31, 2005, the loan was repaid in full with interest.

In August 2005, the Company entered into a Venture Loan and Security Agreement with Oxford Finance Corporation and Horizon Technology Funding Company LLC, pursuant to which we may borrow up to \$15.0 million. The full \$15.0 million loan commitment was available until October 15, 2005; \$10.0 million was available until January 31, 2006, and the remaining \$5.0 million was available until May 31, 2006. The Company did not borrow any monies under this loan facility and this facility has expired. In conjunction with this transaction, the Company issued warrants to the lenders to purchase 164,830 shares of common stock at a price of \$9.10 per share, half of which are currently exercisable. None of the remaining warrants will vest or become exercisable. The Company also granted the lenders registration rights under our Eighth Amended and Restated Investor Rights Agreement.

The fair values of the warrant issued is \$498,438, as determined using the Black-Scholes options pricing model, and are being accounted for as prepaid interest and expensed on a straight-line basis over the term of the agreement. This prepaid interest was fully amortized as of December 31, 2006

Aggregate future minimum payments under all debt arrangements at December 31, 2006 are as follows:

Year ending December 31,	
2007	\$ 1,017,907
2008	688,675
2009	307,111
2010	42,251
Total minimum payments	2,055,944
Less amount representing interest	(214,976)
Present value of minimum payments	1,840,968
Less current portion	(885,273)
Long-term portion	<u>\$ 955,695</u>

9. Commitments

In May 2000, the Company entered into a noncancellable operating lease for its facilities in South San Francisco, California, which expires in June 2013, subject to our option to extend the lease through June 2018.

In December 2006 the Company entered into a noncancellable operating lease for additional office space of approximately 15,000 square feet in a building near to its main office in South San Francisco, California beginning March 1, 2007. This lease expires in April 2013, subject to the Company's option to extend the lease through February 2014.

Following is a schedule of the company's noncancellable lease commitments:

Year ended December 31,	
2007	\$ 3,008,539
2008	3,250,122
2009	3,345,826
2010	3,444,125
2011	3,545,096
2012 and thereafter	5,430,307
	<u>\$22,024,015</u>

The operating lease agreement provides for increasing monthly rent payment over the lease term. The Company recognizes rent expense on a straight-line basis. For the year ended December 31, 2006, 2005 and 2004, the Company recorded rent expense \$2,812,914, \$2,812,914 and 2,817,186, respectively. The deferred rent balance of \$1,464,902 and \$1,369,104 at December 31, 2006 and 2005, respectively, represents the difference between actual rent payments and the straight-line expense.

10. Contingencies

From time to time, the Company may become involved in claims and other legal matters arising in the ordinary course of business. As of December 31, 2006, management is not aware of any matters that could have a material adverse effect on the financial position, results of operations or cash flows of the Company.

11. Stockholders' Equity

In December 2004, the Board of Directors and stockholders of the Company approved an amendment to the certificate of incorporation filed with the State of Delaware. Under the terms of the amended certificate of incorporation, the authorized common stock increased to 110,000,000 shares and the authorized preferred stock increased to 38,582,000 shares with 8,682,000 shares designated as Series A Preferred Stock, 10,600,000 shares designated as Series B Preferred Stock, 13,250,000 shares designated as Series C Preferred Stock, 1,250,000 shares designated as Series C-1 Preferred Stock, and 4,800,000 shares designated as Series C-2 Preferred Stock.

Initial Public Offering (IPO)

On September 30, 2005, the Company completed the IPO of 6,000,000 shares of its common stock at a public offering price of \$7.00 per share. On November 1, 2005, the Company sold an additional 51,126 shares of common stock in connection with the partial exercise of the underwriters' over-allotment option. Net cash proceeds from the IPO were approximately \$37.2 million (including proceeds from the partial exercise of the over-allotment option) after deducting underwriting discounts and commissions and other offering expenses. In connection with the closing of the IPO, all of the Company's shares of convertible preferred stock outstanding at the time of the IPO were automatically converted into 14,027,236 shares of common stock. Concurrent with the conversion of the preferred stock to common stock, the Company recorded a one-time non-cash deemed dividend of \$88.1 million. This non-cash dividend results from the redistribution of pre-IPO ownership which occurred in conjunction with the Company's IPO in accordance with an ownership adjustment mechanism approved by the Company's stockholders. The redistribution of ownership is accounted for as a deemed dividend and the price used for calculating the dividend was the estimated fair market value of the Company per share in December 2004 when the ownership adjustment agreement was reached between the Company's stockholders.

In December 2004, the Board of Directors and stockholders of the Company approved an amendment to the Company's amended and restated certificate of incorporation to be effective upon the completion of the Company's IPO (the "Post-IPO Certificate"). Under the terms of the Post-IPO Certificate, the total number of shares that the Corporation is authorized to issue is 105,000,000 shares, with 100,000,000 shares designated as common stock and 5,000,000 shares designated as preferred stock. The Post-IPO Certificate became effective on September 30, 2005.

Private Placement

In March 2006, the Company entered into a Common Stock and Warrant Purchase Agreement pursuant to which it sold to certain investors, for an aggregate purchase price of approximately \$45.3 million, 7,246,377 shares of its common stock and warrants to purchase up to 2,173,914 additional shares of its common stock. The purchase price for the common stock and the exercise price for the warrants is \$6.21 per share. Investors in the financing paid an additional purchase price equal to \$0.125 for each share of common stock underlying the warrants. All securities were sold in a private placement exempt from registration under the Securities Act of 1933, as amended by virtue of Section 4(2) and/or Regulation D promulgated thereunder as transactions not involving any public offering. The Company received net proceeds of approximately \$43.7 million in this offering. The shares of common stock and the shares issuable upon the exercise of warrants sold in this private placement were registered with the SEC on a registration statement which was declared effective on May 10, 2006.

Common Stock

Holders of common stock are entitled to one vote per share on all matters to be voted upon by the stockholders of the Company. Subject to the preferences that may be applicable to any outstanding shares

of preferred stock, the holders of common stock are entitled to receive ratably such dividends, if any, as may be declared by the Board of Directors. No dividends have been declared to date.

Preferred Stock

The Company has 5,000,000 shares of authorized preferred stock issuable in one or more series. Upon issuance the Company can determine the rights, preferences, privileges and restrictions thereof. These rights, preferences and privileges could include dividend rights, conversion rights, voting rights, terms of redemption, liquidation preferences, sinking fund terms and the number of shares constituting any series or the designation of such series, any or all of which may be greater than the rights of common stock. The issuance of the preferred stock could adversely affect the voting power of holders of common stock and the likelihood that such holders will receive dividend payment and payments upon liquidation. In addition, the issuance of preferred stock could have the effect of delaying, deferring or preventing a change in control of the Company or other corporate action. There was no preferred stock outstanding as of December 31, 2006 or 2005.

Stock Option Plans

With regard to option granting, the Company generally grants options (i) to new employees which become exercisable 25% on the first anniversary of the vesting commencement date and then 1/48th for each month thereafter, and (ii) to existing employees which become exercisable 1/48th the month following the grant date and then at the rate of 1/48th each month thereafter.

1998 Stock Plan and 2001 Stock Plan

The Company's 1998 Stock Plan (the "1998 Plan") was adopted by the Board of Directors in February 1998 and provides for the issuance of common stock, purchase rights, and granting of options to employees, officers, directors, and consultants of the Company. The Company grants shares of common stock for issuance under the 1998 Plan at no less than the fair value of the underlying stock on the grant date, as determined by the Board of Directors. Options granted and shares underlying stock purchase rights issued under the 1998 Plan vest over periods determined by the Board of Directors, generally four years, and expire no more than 10 years after the date of grant. Stock that is purchased prior to vesting is subject to the Company's right of repurchase, which lapses over the vesting period.

In October 2001, the Company's Board of Directors adopted the 2001 Stock Plan, or 2001 Plan, under which shares may be allocated for grant as either incentive stock options or non statutory stock option grants directly from available shares authorized and reserved for issuance under the 1998 Plan. The options vest as determined by the Board of Directors and expire no more than 10 years after the date of grant. The terms of the 2001 Plan are substantially consistent with the 1998 Plan.

Effective in October 2001, any unvested shares repurchased by the Company after that date at their original issue prices will become available for future grant in both plans. Upon the Company's IPO, no shares were available for grant under the 1998 Plan and the 2001 Plan. As of December 31, 2006 and 2005, 0 and 880 shares, respectively, of common stock purchased upon option exercises are subject to repurchase by the Company.

2005 Equity Incentive Award Plan

In February 2005, the Board of Directors adopted and in September 2005, the stockholders approved the 2005 Equity Incentive Award Plan (the "2005 Plan"). The 2005 Plan is intended to serve as the successor equity incentive program to the 1998 Plan and 2001 Plan. The Company has initially reserved a total of 1,779,396 shares of common stock for issuance under the 2005 Plan plus any options granted under the Company's 1998 Plan or 2001 Plan that expire unexercised or are repurchased by the Company

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pursuant to the terms of such options. As of December 31, 2006, 2,403,773 shares have been granted under the 2005 Plan and 2,760 shares have been issued under this plan.

The number of shares of common stock reserved under the 2005 Plan will automatically increase on the first trading day each year, beginning in 2006, by an amount equal to the least of: (i) 4% of the Company's outstanding shares of common stock outstanding on such date, (ii) 1,082,352 shares, or (iii) a lesser amount determined by the Board of Directors. On January 1, 2006, the 2005 Plan was increased by 860,445 shares according to this provision and based on Board approval. The total shares available for future grants under this 2005 Plan as of December 31, 2006 was 396,716. The maximum aggregate number of shares which may be issued or transferred over the term of the 2005 Plan is 11,294,112 shares. In addition, no participant in the 2005 Plan may be issued or transferred more than 235,294 shares of common stock per calendar year pursuant to awards under the 2005 Plan.

2006 Employment Commencement Incentive Plan

In November 2005, the Board of Directors adopted the 2006 Employment Commencement Incentive Plan ("2006 Plan"), which became effective on January 1, 2006. The awards granted pursuant to the 2006 Plan are intended to be inducement awards pursuant to Nasdaq Marketplace Rule 4350(i)(1)(A)(iv). The 2006 Plan is not subject to the approval of the Company's stockholders. Effective January 1, 2007, the Company's Board of Directors increased the 2006 Plan by an additional 200,000 shares such that the aggregate number of shares of common stock reserved for issuance under the 2006 Plan is 400,000 shares. Only those employees who have not previously been employees or directors of the Company or a subsidiary of the Company, or following a bona fide period of non-employment by the Company or a subsidiary of the Company, are eligible to participate in the 2006 Plan. Additionally, grants awarded to such employees under the 2006 Plan must be made in connection with his or her commencement of employment with the Company or a subsidiary of the Company and must be an inducement material to his or her entering into employment with the Company or a subsidiary of the Company. As of December 31, 2006, 120,000 shares have been granted under the 2006 Plan and no shares have been issued under this plan.

Employee Stock Purchase Plan

In February 2005, the Board of Directors adopted and in September 2005, the stockholders approved the 2005 Employee Stock Purchase Plan ("ESPP"). The Company initially reserved a total of 202,941 shares of common stock for issuance under the ESPP. The ESPP permits eligible employees to purchase common stock at a discount through payroll deductions during defined offering periods. Eligible employees can purchase shares of the Company's common stock at 85% of the lower of the fair market value of the common stock at the beginning of an offering period or at the purchase date. As of December 31, 2006, and 2005, 145,632 and 0 shares, respectively, have been issued under the ESPP.

The number of shares of common stock reserved under the ESPP will automatically increase on the first trading day each year, beginning in 2006, by an amount equal to the least of: (i) 0.5% of the Company's outstanding shares of common stock outstanding on such date, (ii) 135,294 shares, or (iii) a lesser amount determined by the Board of Directors. On January 1, 2006, the ESPP was increased by 107,556 shares according to this provision and based on Board approval. At December 31, 2006, the total shares reserved for future issuance under the ESPP was 164,865. The maximum aggregate number of shares which may be issued over the term of the ESPP is 1,352,941 shares. In addition, no participant in the ESPP may be issued or transferred more than \$25,000 of shares of common stock per calendar year pursuant to awards under the ESPP. No one may purchase more than 1,176 shares during any purchase period. The total estimated fair value of purchase rights outstanding under the ESPP that vested during the year ended December 31, 2006 was approximately \$359,000.

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Warrants

The Company has outstanding warrants to purchase common stock at December 31, 2006:

	<u>Shares</u>	<u>Exercise Price</u>	<u>Expiration</u>
	8,863	\$ 5.50	September 2008
	23,529	4.25	April 2008
	20,800	8.94	December 2009
	41,176	17.00	May 2010
	256,740	9.10	July 2010
	1,046	9.10	September 2015
	164,830	9.10	August 2015
	1,582	9.10	June 2013
	757	9.10	June 2014
	2,173,914	6.21	March 2013
Total	<u>2,693,237</u>		

Reserved Shares

As of December 31, 2006, we had reserved shares of common stock for future issuance as follows:

	<u>Shares Available for Future Grant</u>	<u>Shares Outstanding</u>	<u>Total Shares Reserved</u>
Warrants	—	2,693,237	2,693,237

Stock option plans	476,716	3,942,435	4,419,151
Employee stock purchase plan	164,865	—	164,865
Total	<u>641,581</u>	<u>6,635,672</u>	<u>7,277,253</u>

12. Stock-Based Compensation

Stock-Based Compensation Information under FAS 123R

The weighted-average estimated fair value of employee stock options granted during the years ended December 31, 2006, 2005, and 2004 was \$3.43, \$4.05, and \$7.95, respectively, using the Black-Scholes model with the following assumptions:

	Year Ended December 31,		
	2006	2005	2004
	Stock Option Plans		
Risk-free interest rate	4.35% - 5.07%	3.58% - 4.40%	4.2%
Dividend yield	0%	0%	0%
Volatility	80.00%	80.00%	0%
Annual forfeiture rate	5.52%	0%	0%
Expected term (years)	5	5	5

The Company recorded \$403,378, \$1,280,267, respectively, of stock-based compensation expense during the year ended December 31, 2006 related to stock-based awards granted during 2006 and 2005, respectively.

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The weighted average estimated fair value of purchase rights under our Employee Stock Purchase Plan (“ESPP”) for the year ended December 31, 2006 was \$2.47 per share using the Black-Scholes model with the following assumptions:

	Year Ended December 31,	
	2006	2005
	Employee Stock Purchase Plan	
Volatility	80.00%	80.00%
Risk-free interest rate	3.90% - 5.06%	3.90% - 4.32%
Dividend yield	0%	0%
Expected term (years)	0.50 - 1.00	0.50 - 0.67

The Company has based its assumptions for volatility and expected term of employee stock options on the information available with respect to its mature peer group in the same industry. The expected term of the employees’ purchase rights is equal to the purchase period. The assumption for volatility has not changed due to the adoption of FAS 123R. The risk-free interest rate assumption is based upon observed interest rates appropriate for the expected life of the Company’s employee stock options and employees’ purchase rights. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option valuation model. The post-vesting forfeiture rate is derived from the Company’s historical option cancellation information.

As a result of adopting FAS 123R on January 1, 2006, the Company’s net loss for the year ended December 31, 2006 is \$1,898,719 larger than if it had continued to account for stock-based compensation under APB 25. Basic and diluted net loss per common share for the year ended December 31, 2006 is \$1.13 and \$0.07 lower than if the Company had continued to account for stock-based compensation under APB 25.

A summary of stock option transactions for all stock option plans is as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2003	1,370,486	\$ 2.46		
Options granted	476,729	\$ 2.65		
Options exercised	(111,705)	\$ 2.66		
Options canceled/forfeited/expired	(55,353)	\$ 1.98		
Outstanding at December 31, 2004	1,680,157	\$ 2.55		
Options granted	1,389,132	\$ 5.53		
Options exercised	(40,666)	\$ 2.59		
Awards issued	(2,667)	\$ —		
Options canceled/forfeited/expired	(31,255)	\$ 3.11		
Outstanding at December 31, 2005	2,994,701	\$ 3.92		
Options granted	1,227,700	\$ 5.11		
Options exercised	(126,594)	\$ 2.51		
Options canceled/forfeited/expired	(153,372)	\$ 4.86		
Outstanding at December 31, 2006	<u>3,942,435</u>	<u>\$ 4.30</u>	<u>8.05</u>	<u>\$ 2,867</u>
Exercisable at December 31, 2006	<u>1,745,149</u>	<u>\$ 3.36</u>	<u>6.59</u>	<u>\$ 2,571</u>

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (i.e., the difference between the Company’s closing stock price on the last trading day of its fourth quarter of 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received

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by the option holders had all option holders exercised their options on December 31, 2006. This amount changes based on the fair market value of the Company's common stock. Total intrinsic value of options exercised is \$360,000 and \$193,000 for the years ended December 31, 2006 and 2005, respectively.

The following table summarizes information about stock options outstanding and exercisable at December 31, 2006:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number of Shares	Weighted Average Remaining Contractual Life (In Years)	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
\$0.43 to \$ 1.28	24,946	2.69	\$ 0.80	24,946	\$ 0.80
\$2.55	1,379,556	5.93	\$ 2.55	1,241,400	\$ 2.55
\$3.19 to \$4.74	173,756	9.25	\$ 4.27	30,064	\$ 3.44
\$4.85	749,800	9.78	\$ 4.85	31,201	\$ 4.85
\$4.93 to \$5.162	129,800	9.50	\$ 5.04	11,745	\$ 5.13
\$5.25	1,156,096	8.91	\$ 5.25	328,483	\$ 5.25
\$5.50 to \$6.35	195,400	9.55	\$ 5.99	30,000	\$ 6.01
\$6.40	23,900	9.32	\$ 6.40	—	\$ —
\$7.15	22,400	9.25	\$ 7.15	—	\$ —
\$9.56	86,781	8.43	\$ 9.56	47,310	\$ 9.56
\$0.43 to \$9.56	<u>3,942,435</u>	8.05	\$ 4.30	<u>1,745,149</u>	\$ 3.36

The Company's determination of the fair value of share-based payment awards on the grant date using an option-pricing model is affected by the Company's stock price as well as assumptions regarding a number of highly subjective variables. The estimated fair value of shares vested during the year of 2006 was \$1,980,000, and was \$91,000 for the year of 2005. At December 31, 2006, total unrecognized estimated compensation cost related to non-vested stock options granted prior to that date was approximately \$7,566,000 and the cost is expected to be recognized over the respective vesting terms of each award through 2010. The weighted average term of the unrecognized stock-based compensation expense is 2.71 years. As it is more likely than not that all of the stock option related tax benefits will not be realized, the Company did not record net tax benefits related to the options exercised in 2006.

Stock Compensation for Options Granted Prior to the IPO

Prior to the Company's IPO, certain stock options were granted with exercise prices that were below the reassessed fair value of the common stock at the date of grant. In accordance with APB 25, deferred stock compensation was recorded for the difference between the estimated fair value of the common stock underlying the options and the exercise price of the options. The deferred stock compensation is being amortized over the related vesting terms of the options. The Company recorded amortization of deferred stock compensation of \$723,213 in 2006 under the prospective transition method of FAS 123R for stock options granted before December 23, 2004, the date on which the Company filed its initial registration statement on Form S-1 in connection with its IPO. For stock options granted after December 23, 2004, the associated unamortized deferred compensation balance of \$304,820 was reversed as of January 1, 2006 due to the adoption of FAS 123R.

As of December 31, 2006, the expected future amortization expense for deferred stock compensation during each of the following periods is as follows:

Year ending December 31,	
2007	\$ 679,390
2008	327,214
Total amount to be amortized	<u>\$ 1,006,604</u>

Total Stock-based Compensation Expense

Employee stock-based compensation expense recognized in 2006 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures. FAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Employee stock-based compensation expense related to all of the Company's stock-based awards, including, stock options granted prior to the Company's IPO which continue to be accounted for under APB 25, is as follows:

	Year ended December 31, 2006
Research and development	\$ 1,245,345
General and administrative	1,524,521
Stock-based compensation expense	<u>\$ 2,769,866</u>

Pro Forma Information under SFAS 123 for Periods Prior to 2006

Prior to January 1, 2006, the Company followed the disclosure-only provisions of SFAS 123, as amended. The following table illustrates the effect on net loss and loss per common share for the years ended December 31, 2005 and 2004 if the fair value recognition provisions of SFAS 123, as amended, had been applied to options granted under the Company's equity-based employee compensation plans. For purposes of this pro forma disclosure, the estimated value of the options is recognized over the options' vesting periods. If the Company had recognized the expense of equity programs in the statement of operations, additional paid-in capital would have increased by a corresponding amount. For stock options accounted for under the prospective transition method consisting of those options granted prior to the initial filing of the Company's Form S-1, no pro forma disclosures have been provided.

	Year Ended December 31,	
	2005	2004
Net loss applicable to common stockholders, as reported	\$ (115,591,259)	\$ (20,530,200)
Add: employee stock-based compensation based on the intrinsic value method	1,067,110	424,018

Deduct: total employee stock-based compensation expense determined under the fair value method for all awards	(1,410,646)	(649,089)
Pro forma loss applicable to common stockholders	<u>\$ (115,934,795)</u>	<u>\$ (20,755,271)</u>
Net loss per share applicable to common stockholders:		
Basic and diluted, as reported	\$ (17.41)	\$ (15.77)
Basic and diluted, pro forma	<u>\$ (17.47)</u>	<u>\$ (15.94)</u>

13. Income Taxes

As of December 31, 2006 the Company had federal net operating loss carryforwards of approximately \$128.4 million. The Company also had federal research and development tax credit carryforwards of approximately \$1.7 million. The net operating loss and tax credit carryforwards will expire at various dates

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beginning in 2018, if not utilized. As of December 31, 2006, the Company had a state net operating loss carryforward of approximately \$60.0 million, which expires beginning in 2008. The Company also had state research and development tax credit carryforwards of approximately \$1.7 million which do not expire.

Utilization of the net operating loss and tax credits carryforwards may be subject to a substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code of 1986, as amended, that are applicable if the Company experiences an "ownership change," which may occur, for example, as a result of the Company's initial public offering and other sales of the Company's stock, and similar state provisions. The annual limitation may result in the expiration of net operating losses and credits before utilization.

As of December 31, 2006 and 2005, the Company had deferred tax assets of approximately \$61,666,000 and \$49,273,000, respectively. Realization of the deferred tax assets is dependent upon future taxable income, if any, the amount and timing of which are uncertain. Accordingly, the net deferred tax assets have been fully offset by a valuation allowance. The net valuation allowance increased by approximately \$12,393,000 and \$10,726,000, during the years ended December 31, 2006, and 2005, respectively.

The income tax provision differs from the amount computed by applying the statutory income tax rate of 34% to pretax loss as follows:

	Year Ended December 31,		
	2006	2005	2004
At statutory rate	\$ (10,620,396)	\$ (9,349,372)	\$ (6,980,268)
Current year net operating losses and temporary differences for which no tax benefit is recognized	9,871,419	8,725,909	6,737,902
Other permanent differences	748,977	623,463	242,366
	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

Deferred income taxes reflect the net tax effects of loss and credit carryforwards and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets for federal and state income taxes are as follows:

	December 31,	
	2006	2005
Deferred tax assets:		
Net operating loss carryforwards	\$ 47,259,000	\$ 38,773,000
Deferred revenue	1,328,000	2,843,000
Capitalized research costs	7,535,000	3,087,000
Property and equipment	1,268,000	1,197,000
Accrued liabilities	1,097,000	781,000
Federal and state research credit carryforwards	6,047,000	4,915,000
Gross deferred tax assets	64,534,000	51,596,000
Valuation allowance	(64,534,000)	(51,596,000)
Net deferred tax assets	<u>\$ —</u>	<u>\$ —</u>

The 2005 deferred tax assets have been revised to reflect the gross amounts of tax credit carryforwards with the corresponding increase in the valuation allowance.

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14. Selected Quarterly Financial Data (unaudited)

	Three Months Ended							
	Mar. 31, 2006	June 30, 2006	Sep. 30, 2006	Dec. 31, 2006	Mar. 31, 2005	June 30, 2005	Sep. 30, 2005	Dec. 31, 2005
Revenue	\$ 3,097,465	\$ 6,707,653	\$ 1,949,091	\$ 1,954,977	\$ 3,903,093	\$ 4,751,142	\$ 3,344,978	\$ 4,522,637
Net loss	\$ (8,977,710)	\$ (4,495,906)	\$ (8,733,643)	\$ (9,030,002)	\$ (4,532,005)	\$ (12,010,228)	\$ (93,734,322)	\$ (5,314,704)
Basic and diluted loss per share applicable to common stockholders	\$ (0.39)	\$ (0.15)	\$ (0.30)	\$ (0.31)	\$ (3.28)	\$ (8.55)	\$ (44.57)	\$ (0.25)
Shares used in computing basic and diluted net loss per share applicable to common stockholders	22,968,484	29,256,267	29,333,909	29,386,886	1,379,723	1,404,129	2,103,296	21,493,392

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

(a) *Evaluation of Disclosure Controls and Procedures:* The Company's principal executive and financial officers reviewed and evaluated our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this Form 10-K. Based on that evaluation, the Company's principal executive and financial officers concluded that the Company's disclosure controls and procedures are effective in timely providing them with material information relating to the Company, as required to be disclosed in the reports the Company files under the Exchange Act.

(b) *Management's Annual Report on Internal Control Over Financial Reporting:* The Company's management is responsible for establishing and maintaining adequate internal control over the Company's financial reporting. Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (or "COSO") in *Internal Control-Integrated Framework*. Based on the assessment using those criteria, management concluded that, as of December 31, 2006, our internal control over financial reporting was effective. The Company's independent registered public accountants, Ernst & Young LLP, audited the financial statements included in this Annual Report on Form 10-K and have issued an audit report on management's assessment of our internal control over financial reporting as well as on the effectiveness of the Company's internal control over financial reporting. The report on the audit of internal control over financial reporting appears below.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Sunesis Pharmaceuticals, Inc.

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting, that Sunesis Pharmaceuticals, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Sunesis Pharmaceuticals, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of Sunesis Pharmaceuticals, Inc.'s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Sunesis Pharmaceuticals, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Sunesis Pharmaceuticals, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheets of Sunesis Pharmaceuticals, Inc. as of December 31, 2006 and 2005, and the related statements of operations, convertible preferred stock and stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 2006 and our report dated March 9, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Jose, California
March 9, 2007

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(c) *Changes in Internal Controls over Financial Reporting:* There were no changes in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

We have adopted a code of business conduct and ethics which applies to all of our directors, officers and employees. A copy of our code of business conduct and ethics can be found on our website, www.sunesis.com in the section titled "Investors and Media" under the subsection titled "Corporate Governance." To the extent required by law or Nasdaq rules, any amendments to, or waivers from, any provision of the code will be promptly disclosed publicly. To the extent permitted by such requirements, we intend to make such public disclosure by posting the relevant material on the corporate governance page of the investor relations section of our website in accordance with SEC rules. Stockholders may download a copy of the Code of Business Conduct and Ethics from our website.

All additional information required by this item is incorporated by reference to our Definitive Proxy statement to be filed with the Securities and Exchange Commission in connection with the Annual Meeting of our Stockholders (the "Proxy Statement"), which is expected to be filed not later than 120 days after the end of our fiscal year ended December 31, 2006.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item will be set forth in the Proxy Statement and is incorporated in this report by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item will be set forth in the Proxy Statement and is incorporated in this report by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this item will be set forth in the Proxy Statement and is incorporated in this report by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item will be set forth in the Proxy Statement and is incorporated in this report by reference.

PART IV

ITEM 15. EXHIBIT, FINANCIAL STATEMENT SCHEDULES

(a) Exhibits and Financial Statement Schedules:

(1) *Financial Statements*

See the "Index to Financial Statements" in Part II Item 8 of this report.

(2) *Financial Statement Schedules*

All financial statement schedules are omitted because they are not applicable, or the information is included in the financial statements or notes thereto.

(3) *Exhibits*

A list of exhibits filed with this Form 10-K or incorporated by reference is found in the Exhibit Index immediately following signature page of this report.

(b) Exhibits:

See Item 15(a)(3) above.

(c) Financial Schedules:

See Item 15(a)(2) above.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Sunesis Pharmaceuticals, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on March 15, 2007.

SUNESIS PHARMACEUTICALS, INC.

By: /s/ ERIC H. BJERKHOLT
Eric H. Bjerkholt
Senior Vice President, Corporate Development
and Finance, Chief Financial Officer

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.

Signature

Title

Date

/s/ JAMES W. YOUNG, PH.D.
James W. Young, Ph.D.

Executive Chairman of the Board

March 15, 2007

<u>/s/ DANIEL N. SWISHER, JR.</u> Daniel N. Swisher, Jr.	President, Chief Executive Officer and Director (<i>Principal Executive Officer</i>)	March 15, 2007
<u>/s/ ERIC H. BJERKHOLT</u> Eric H. Bjerkholt	Senior Vice President, Corporate Development and Finance, Chief Financial Officer (<i>Principal Financial Officer and Principal Accounting Officer</i>)	March 15, 2007
<u>/s/ ANTHONY B. EVNIN, PH.D.</u> Anthony B. Evinin, Ph.D.	Director	March 15, 2007
<u>/s/ STEPHEN P.A. FODOR, PH.D.</u> Stephen P.A. Fodor, Ph.D.	Director	March 15, 2007
<u>/s/ MATTHEW K. FUST</u> Matthew K. Fust	Director	March 15, 2007
<u>/s/ STEVEN D. GOLDBY</u> Steven D. Goldby	Director	March 15, 2007
<u>/s/ JONATHAN S. LEFF</u> Jonathan S. Leff	Director	March 15, 2007
<u>/s/ HOMER L. PEARCE, PH.D.</u> Homer L. Pearce	Director	March 15, 2007
<u>/s/ DAVID C. STUMP, M.D.</u> David C. Stump, M.D.	Director	March 15, 2007
<u>/s/ JAMES A. WELLS, PH.D.</u> James A. Wells, Ph.D.	Director	March 15, 2007

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EXHIBIT INDEX

Exhibit Number	Description
3.1	Amended and Restated Certificate of Incorporation of the Registrant (Delaware) (incorporated by reference to Exhibit 3.4 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on December 23, 2004).
3.2	Amended and Restated Bylaws of the Registrant (incorporated by reference to Exhibit 3.6 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on December 23, 2004).
4.1	Specimen Common Stock certificate of the Registrant (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on December 23, 2004).
10.1*	1998 Stock Plan and Form of Stock Option Agreement (incorporated by reference to Exhibit 10.1 to Amendment No. 1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on January 27, 2005).
10.2*	2001 Stock Plan and Form of Stock Option Agreement (incorporated by reference to Exhibit 10.2 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on December 23, 2004).
10.3*	2005 Equity Incentive Award Plan and Form of Stock Option Agreement (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on November 9, 2006).
10.4*	Employee Stock Purchase Plan and Enrollment Form (incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q filed on November 9, 2006).
10.5*	Form of Indemnification Agreement for directors and executive officers (incorporated by reference to Exhibit 10.5 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on December 23, 2004).
10.6*	Executive Severance Benefits Agreement, dated August 4, 2005, by and between the Registrant and Daniel N. Swisher, Jr. (incorporated by reference to Exhibit 10.6 to Amendment No. 4 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on September 1, 2005).
10.7*	Executive Severance Benefits Agreement, dated November 1, 2006, by and between the Registrant and Daryl B. Winter, Ph.D. (incorporated by reference to the Company's Current Report on Form 8-K filed on November 7, 2006).
10.8*	Executive Severance Benefits Agreement, dated August 5, 2005, by and between the Registrant and James W. Young, Ph.D. (incorporated by reference to Exhibit 10.8 to Amendment No. 4 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on September 1, 2005).
10.9*	Executive Severance Benefits Agreement, dated August 8, 2005, by and between the Registrant and Daniel C. Adelman, M.D. (incorporated by reference to Exhibit 10.9 to Amendment No. 4 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on September 1, 2005).
10.10*	Executive Severance Benefits Agreement, dated August 12, 2005, by and between the Registrant and Eric H. Bjerkholt (incorporated by reference to Exhibit 10.10 to Amendment No. 4 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on September 1, 2005).

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- 10.11* Bonus Program (incorporated by reference to Exhibit 10.11 to Amendment No. 4 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on September 1, 2005).
- 10.12* Consulting Agreement, dated August 8, 2005, by and between the Registrant and James A. Wells (incorporated by reference to Exhibit 10.12 to Amendment No. 4 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on September 1, 2005).
- 10.13 Promissory Note, dated December 18, 2002, by and between the Registrant and Biogen, Inc., for principal amount of up to \$4,000,000 (incorporated by reference to Exhibit 10.16 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on December 23, 2004).
- 10.14 Eighth Amended and Restated Investor Rights Agreement, dated August 30, 2004, by and among the Registrant and certain stockholders and warrant holders (incorporated by reference to Exhibit 10.17 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on December 23, 2004).
- 10.15 Warrant, dated April 9, 1998, issued to James A. Wells (incorporated by reference to Exhibit 10.18 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on December 23, 2004).
- 10.16 Warrant, dated December 1, 1999, issued to Three Crowns Capital (Bermuda) Limited (incorporated by reference to Exhibit 10.19 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on December 23, 2004).
- 10.17 Warrant, dated July 7, 2000, issued to Broadview Ltd. Limited and Amendment No. 1 thereto, dated December 2004 (incorporated by reference to Exhibit 10.20 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on December 23, 2004).
- 10.18 Warrant, dated June 11, 2003, issued to General Electric Capital Corporation (incorporated by reference to Exhibit 10.21 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on December 23, 2004).
- 10.19 Warrant, dated June 21, 2004, issued to General Electric Capital Corporation and Amendment No. 1 thereto, dated December 16, 2004 (incorporated by reference to Exhibit 10.22 to Amendment No. 2 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on April 29, 2005).
- 10.20 Lease, dated May 12, 2000, by and between the Registrant and ARE-Technology Centers SSF, LLC, for office space located at 341 Oyster Point Boulevard, South San Francisco, California (incorporated by reference to Exhibit 10.23 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on December 23, 2004).
- 10.21 First Amendment to Lease Agreement, dated December 20, 2000, by and between the Registrant and ARE-Technology Centers SSF, LLC for office space located at 341 Oyster Point Boulevard, South San Francisco, California (incorporated by reference to Exhibit 10.24 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on December 23, 2004).
- 10.22 Master Security Agreement, dated June 15, 2000 and amendments thereto, by and between the Registrant and General Electric Capital Corporation, Negative Pledge Agreement, dated May 17, 2002, and Form of Promissory Note (incorporated by reference to Exhibit 10.25 to Amendment No. 2 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on April 29, 2005).

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- 10.23 Loan Term Sheet, dated July 8, 2005, by and between the Registrant and General Electric Capital Corporation (incorporated by reference to Exhibit 10.23 to Amendment No. 4 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on September 1, 2005).
- 10.24† Collaboration Agreement, dated December 18, 2002, by and between the Registrant and Biogen, Inc. (now Biogen Idec MA Inc.) (incorporated by reference to Exhibit 10.26 to Amendment No. 1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on January 27, 2005).
- 10.25† Amendment No. 1 to Collaboration Agreement, dated June 17, 2003, between the Registrant and Biogen Idec MA Inc. (incorporated by reference to Exhibit 10.27 to Amendment No. 1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on January 27, 2005).
- 10.26† Amendment No. 2 to Collaboration Agreement, dated September 17, 2003, between the Registrant and Biogen Idec MA Inc. (incorporated by reference to Exhibit 10.28 to Amendment No. 1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on January 27, 2005).
- 10.27† Collaboration Agreement, dated August 25, 2004, between the Registrant and Biogen Idec MA Inc. (incorporated by reference to Exhibit 10.29 to Amendment No. 2 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on April 29, 2005).
- 10.28† Collaboration Agreement, dated May 3, 2002, by and between the Registrant and Johnson & Johnson Pharmaceutical Research & Development, LLC (incorporated by reference to Exhibit 10.30 to Amendment No. 1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on January 27, 2005).
- 10.29† Amendment to Collaboration Agreement, dated December 15, 2002, between the Registrant and Johnson & Johnson Pharmaceutical Research & Development, LLC (incorporated by reference to Exhibit 10.31 to Amendment No. 1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on January 27, 2005).
- 10.30† Notice of Extension and Second Amendment to Collaboration Agreement, dated December 15, 2003, between the Registrant and Johnson & Johnson Pharmaceutical Research & Development, LLC (incorporated by reference to Exhibit 10.32 to Amendment No. 1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on January 27, 2005).
- 10.31† Third Amendment to Collaboration Agreement, dated December 22, 2004, between the Registrant and Johnson & Johnson Pharmaceutical Research & Development, LLC (incorporated by reference to Exhibit 10.33 to Amendment No. 2 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on April 29, 2005).

10.32†	License and Collaboration Agreement, dated February 12, 2003, by and between the Registrant and Merck & Co., Inc. (incorporated by reference to Exhibit 10.34 to Amendment No. 1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on January 27, 2005).
10.33†	License and Research Collaboration Agreement, dated July 22, 2004, by and between the Registrant and Merck & Co., Inc. (incorporated by reference to Exhibit 10.35 to Amendment No. 1 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on January 27, 2005).
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10.34†	License Agreement, dated October 14, 2003, by and between the Registrant and Dainippon Sumitomo Pharma Co., Ltd. (formerly known as Dainippon Pharmaceutical Co., Ltd.) (incorporated by reference to Exhibit 10.36 to Amendment No. 2 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on April 29, 2005).
10.35†	License Agreement, dated as of April 27, 2005, between the Registrant and Bristol-Meyers Squibb Company (incorporated by reference to Exhibit 10.35 to Amendment No. 4 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on September 1, 2005).
10.36	Stock Purchase Agreement, dated as of April 27, 2005, between the Registrant and Bristol-Meyers Squibb Company (incorporated by reference to Exhibit 10.38 to Amendment No. 2 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on April 29, 2005).
10.37	Amendment to Eighth Amended and Restated Investor Rights Agreement, dated as of April 27, 2005, among the Registrant and Investors listed on the signature pages thereto (incorporated by reference to Exhibit 10.39 to Amendment No. 2 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on April 29, 2005).
10.39	Amendment to Eighth Amended and Restated Investor Rights Agreement, dated as of August 25, 2005, among the Registrant and the Investors listed on the signature pages thereto (incorporated by reference to Exhibit 10.39 to Amendment No. 4 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on September 1, 2005).
10.40	Warrant, dated August 25, 2005, issued to Horizon Technology Funding Company II LLC (incorporated by reference to Exhibit 10.40 to Amendment No. 4 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on September 1, 2005).
10.41	Warrant, dated August 25, 2005, issued to Horizon Technology Funding Company III LLC (incorporated by reference to Exhibit 10.41 to Amendment No. 4 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on September 1, 2005).
10.42	Warrant, dated August 25, 2005, issued to Oxford Finance Corporation (incorporated by reference to Exhibit 10.42 to Amendment No. 4 to the Company's Registration Statement on Form S-1 (SEC File No. 333-121646) filed on September 1, 2005).
10.43	Amended and Restated 2006 Employment Incentive Commencement Plan.
10.44	Common Stock and Warrant Purchase Agreement, dated as of March 17, 2006, among the Company and the Investors listed on the signature pages thereto (incorporated by reference to the Company's Current Report on Form 8-K filed on March 22, 2006).
10.45	Registration Rights Agreement, dated as of March 17, 2006, among the Company and the Investors listed on the signature pages thereto (incorporated by reference to the Company's Current Report on Form 8-K filed on March 22, 2006).
10.46	Form of Warrant (incorporated by reference to the Company's Current Report on Form 8-K filed on March 22, 2006).
10.47†	Sublease, dated December 22, 2006, by and between the Registrant and Oncology Therapeutics Network Joint Venture, L.P., for office space located at 395 Oyster Point Boulevard, South San Francisco, California.
21.1	Subsidiaries of the Registrant.
23.1	Consent of Independent Registered Public Accounting Firm.

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 Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* This exhibit is a management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 15(b) of Form 10-K.

† Portions of the exhibit have been omitted pursuant to a request for confidential treatment. The omitted information has been filed separately with the Securities and Exchange Commission.

SUNESIS PHARMACEUTICALS, INC.
2006 EMPLOYMENT COMMENCEMENT INCENTIVE PLAN

ADOPTED BY THE BOARD OF DIRECTORS ON NOVEMBER 29, 2005

EFFECTIVE AS OF JANUARY 1, 2006

AMENDED AND RESTATED ON SEPTEMBER 13, 2006

FURTHER AMENDED AND RESTATED ON DECEMBER 6, 2006

**ARTICLE 1
PURPOSE**

1.1 General.

(a) Eligible Stock Award Recipients. Only Eligible Participants may receive Awards under the Plan.

(b) General Purpose. The purpose of the Plan is to promote the success and enhance the value of Sunesis Pharmaceuticals, Inc. (the “*Company*”) by linking the personal interests of Eligible Participants to those of Company stockholders and by providing such individuals with an incentive for outstanding performance to generate superior returns to Company stockholders. The Plan is further intended to provide flexibility to the Company in its ability to motivate, attract, and retain the services of Eligible Participants upon whose judgment, interest, and special effort the successful conduct of the Company’s operation will be largely dependent.

**ARTICLE 2
DEFINITIONS AND CONSTRUCTION**

2.1 Definitions. The following words and phrases shall have the following meanings:

(a) “**Award**” means an Option, a Restricted Stock award, a Stock Appreciation Right award, a Performance Share award, a Dividend Equivalent award, a Stock Payment award, or a Restricted Stock Unit award granted to an Eligible Participant pursuant to the Plan.

(b) “**Award Agreement**” means any written agreement, contract, or other instrument or document evidencing an Award.

(c) “**Board**” means the Board of Directors of the Company.

(d) “**Cause**” includes one or more of the following: (i) the commission of an act of fraud, embezzlement or dishonesty by a Participant that has a material adverse impact on the Company or any successor or parent or Subsidiary thereof; (ii) a conviction of, or plea of “guilty” or “no contest” to, a felony by a Participant; (iii) any unauthorized use or disclosure by a Participant of confidential information or trade secrets of the Company or any successor or parent or Subsidiary thereof that has a material adverse impact on any such entity or (iv) any other intentional misconduct by a Participant that has a material adverse impact on the Company or any successor or parent or Subsidiary thereof. However, if the term or concept of “Cause” has been defined in an agreement between a Participant and the Company or any successor or parent or Subsidiary thereof, then “Cause” shall have the definition set forth in such agreement. The foregoing definition shall not in any way preclude or restrict the right of the Company or any successor or

parent or Subsidiary thereof that has a material adverse impact on any such entity or (iv) any other intentional misconduct by a Participant that has a material adverse impact on the Company or any successor or parent or Subsidiary thereof. However, if the term or concept of ‘Cause’ has been defined in an agreement between a Participant and the Company or any successor or parent or Subsidiary thereof, then ‘Cause’ shall have the definition set forth in such agreement. The foregoing definition shall not in any way preclude or restrict the right of the Company or any successor or parent or Subsidiary thereof to discharge or dismiss any Participant in the service of such entity for any other acts or omissions, but such other acts or omissions shall not be deemed, for purposes of this Plan, to constitute grounds for termination for Cause.

(e) “**Change of Control**” means and includes each of the following:

(1) the acquisition, directly or indirectly, by any “person” or “group” (as those terms are defined in Sections 3(a)(9), 13(d) and 14(d) of the Exchange Act and the rules thereunder) of “beneficial ownership” (as determined pursuant to Rule 13d-3 under the Exchange Act) of securities entitled to vote generally in the election of directors (“voting securities”) of the Company that represent 50% or more of the combined voting power of the Company’s then outstanding voting securities, other than:

(A) an acquisition by a trustee or other fiduciary holding securities under any employee benefit plan (or related trust) sponsored or maintained by the Company or any person controlled by the Company or by any employee benefit plan (or related trust) sponsored or maintained by the Company or any person controlled by the Company, or

(B) an acquisition of voting securities by the Company or a corporation owned, directly or indirectly by the stockholders of the Company in substantially the same proportions as their ownership of the stock of the Company;

Notwithstanding the foregoing, the following event shall not constitute an “acquisition” by any person or group for purposes of this subsection (e): an acquisition of the Company’s securities by the Company that causes the Company’s voting securities beneficially owned by a person or group to represent 50% or more of the combined voting power of the Company’s then outstanding voting securities; *provided, however*, that if a person or group shall become the beneficial owner of 50% or more of the combined voting power of the Company’s then outstanding voting securities by reason of share acquisitions by the Company as described above and shall, after such share acquisitions by the Company, become the beneficial owner of any additional voting securities of the Company, then such acquisition shall constitute a Change of Control; or

(2) during any period of two consecutive years, individuals who, at the beginning of such period, constitute the Board together with any new director(s) (other than a director designated by a person who shall have entered into an agreement with the Company to effect a transaction described in clauses (1) or (3) of this subsection (e)) whose election by the Board or nomination for election by the Company's stockholders was approved by a vote of at least two-thirds of the directors then still in office who either were directors at the beginning of the two year period or whose election or nomination for election was previously so approved, cease for any reason to constitute a majority thereof; or

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(3) the consummation by the Company (whether directly involving the Company or indirectly involving the Company through one or more intermediaries) of (x) a merger, consolidation, reorganization, or business combination or (y) a sale or other disposition of all or substantially all of the Company's assets or (z) the acquisition of assets or stock of another entity, in each case other than a transaction:

(A) which results in the Company's voting securities outstanding immediately before the transaction continuing to represent (either by remaining outstanding or by being converted into voting securities of the Company or the person that, as a result of the transaction, controls, directly or indirectly, the Company or owns, directly or indirectly, all or substantially all of the Company's assets or otherwise succeeds to the business of the Company (the Company or such person, the "**Successor Entity**")) directly or indirectly, at least a majority of the combined voting power of the Successor Entity's outstanding voting securities immediately after the transaction, and

(B) after which no person or group beneficially owns voting securities representing 50% or more of the combined voting power of the Successor Entity; *provided, however*, that no person or group shall be treated for purposes of this clause (B) as beneficially owning 50% or more of combined voting power of the Successor Entity solely as a result of the voting power held in the Company prior to the consummation of the transaction; or

(4) the Company's stockholders approve a liquidation or dissolution of the Company.

The Committee shall have full and final authority, which shall be exercised in its discretion, to determine conclusively whether a Change of Control of the Company has occurred pursuant to the above definition, and the date of the occurrence of such Change of Control and any incidental matters relating thereto.

(f) "**Code**" means the Internal Revenue Code of 1986, as amended.

(g) "**Committee**" means the Board or a committee of the Board described in Article 11.

(h) "**Director**" means a member of the Board.

(i) "**Disability**" means, for purposes of the Plan, that the Participant qualifies to receive long-term disability payments under the Company's long-term disability insurance program, as it may be amended from time to time.

(j) "**Dividend Equivalents**" means a right granted to a Participant pursuant to Article 8 to receive the equivalent value (in cash or Stock) of dividends paid on Stock.

(k) "**Eligible Participant**" means any Employee who has not previously been an Employee or Director of the Company or a Subsidiary, or is commencing employment with the Company or a Subsidiary following a bona fide period of non-employment by the Company or a Subsidiary, if he or she is granted an Award in connection with his or her commencement of employment with the Company or a Subsidiary and such grant is an inducement material to his

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or her entering into employment with the Company or a Subsidiary. The Board may in its discretion adopt procedures from time to time to ensure that an Employee is eligible to participate in the Plan prior to the granting of any Awards to such Employee under the Plan (including, without limitation, a requirement, that each such Employee certify to the Company prior to the receipt of an Award under the Plan that he or she has not been previously employed by the Company or a Subsidiary, or if previously employed, has had a bona fide period of non-employment, and that the grant of Awards under the Plan is an inducement material to his or her agreement to enter into employment with the Company or a Subsidiary).

(l) "**Employee**" means any officer or other employee (as defined in accordance with Section 3401(c) of the Code) of the Company or any Subsidiary.

(m) "**Exchange Act**" means the Securities Exchange Act of 1934, as amended.

(n) "**Fair Market Value**" means, as of any date, the value of Stock determined as follows:

(1) If the Stock is listed on any established stock exchange or a national market system, its Fair Market Value shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such exchange or system for such date, or if no bids or sales were reported for such date, then the closing sales price (or the closing bid, if no sales were reported) on the trading date immediately prior to such date during which a bid or sale occurred, in each case, as reported in *The Wall Street Journal* or such other source as the Committee deems reliable;

(2) If the Stock is regularly quoted by a recognized securities dealer but selling prices are not reported, its Fair Market Value shall be the mean of the closing bid and asked prices for the Stock on such date, or if no closing bid and asked prices were reported for such date, the date

immediately prior to such date during which closing bid and asked prices were quoted for the Stock, in each case, as reported in *The Wall Street Journal* or such other source as the Committee deems reliable; or

(3) In the absence of an established market for the Stock, the Fair Market Value thereof shall be determined in good faith by the Committee.

(o) “**Good Reason**” means a Participant’s voluntary resignation following any one or more of the following that is effected without the Participant’s written consent: (i) a change in his or her position following the Change of Control that materially reduces his or her duties or responsibilities, (ii) a reduction in his or her base salary following a Change of Control, unless the base salaries of all similarly situated individuals are similarly reduced, or (iii) a relocation of such Participant’s place of employment following a Change of Control by more than fifty (50) miles from such Participant’s place of employment prior to a Change of Control. However, if the term or concept of “Good Reason” has been defined in an agreement between a Participant and the Company or any successor or parent or Subsidiary thereof, then “Good Reason” shall have the definition set forth in such agreement.

(p) “**Incentive Stock Option**” means an Option that is intended to meet the requirements of Section 422 of the Code or any successor provision thereto. Incentive Stock

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Options may not be granted under the Plan.

(q) “**Independent Director**” means a Director who is not an Employee of the Company and who qualifies as “independent” within the meaning of NASD Rule 4200(a)(15), if the Company’s securities are traded on the Nasdaq National Market, or the requirements of any other established stock exchange on which the Company’s securities are traded, as such rules or requirements may be amended from time to time.

(r) “**NASD**” means the National Association of Securities Dealers, Inc.

(s) “**Non-Qualified Stock Option**” means an Option that is not intended to be an Incentive Stock Option.

(t) “**Option**” means a right granted to a Participant pursuant to Article 5 of the Plan to purchase a specified number of shares of Stock at a specified price during specified time periods. An Option must be a Non-Qualified Stock Option.

(u) “**Participant**” means an Eligible Participant who has been granted an Award pursuant to the Plan.

(v) “**Performance Share**” means a right granted to a Participant pursuant to Article 8, to receive cash, Stock, or other Awards, the payment of which is contingent upon achieving certain performance goals established by the Committee.

(w) “**Plan**” means this Sunesis Pharmaceuticals, Inc. 2006 Employment Commencement Incentive Plan, as it may be amended from time to time.

(x) “**Restricted Stock**” means Stock awarded to a Participant pursuant to Article 6 that is subject to certain restrictions and to risk of forfeiture.

(y) “**Restricted Stock Unit**” means a right to receive a specified number of shares of Stock during specified time periods pursuant to Article 8.

(z) “**Stock**” means the common stock of the Company and such other securities of the Company that may be substituted for Stock pursuant to Article 10.

(aa) “**Stock Appreciation Right**” or “**SAR**” means a right granted pursuant to Article 7 to receive a payment equal to the excess of the Fair Market Value of a specified number of shares of Stock on the date the SAR is exercised over the Fair Market Value on the date the SAR was granted as set forth in the applicable Award Agreement.

(bb) “**Stock Payment**” means (a) a payment in the form of shares of Stock, or (b) an option or other right to purchase shares of Stock, as part of any bonus, deferred compensation or other arrangement, made in lieu of all or any portion of the compensation, granted pursuant to Article 8.

(cc) “**Subsidiary**” means any corporation or other entity of which a majority of the outstanding voting stock or voting power is beneficially owned directly or indirectly by the

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Company.

ARTICLE 3 SHARES SUBJECT TO THE PLAN

3.1 Number of Shares.

(a) Subject to Article 10, the aggregate number of shares of Stock which may be issued or transferred pursuant to Awards under the Plan shall be 400,000 shares.

The payment of Dividend Equivalents in conjunction with any outstanding Awards shall not be counted against the shares available for issuance under the Plan.

(b) To the extent that an Award terminates, expires, or lapses for any reason, any shares of Stock subject to the Award shall again be available for the grant of an Award pursuant to the Plan. Additionally, any shares of Stock tendered or withheld to satisfy the grant or exercise price or tax withholding obligation pursuant to any Award shall again be available for the grant of an Award pursuant to the Plan. To the extent permitted by applicable law or any exchange rule, shares of Stock issued in assumption of, or in substitution for, any outstanding awards of any entity acquired in any form of combination by the Company or any Subsidiary shall not be counted against shares of Stock available for grant pursuant to the Plan.

3.2 Stock Distributed. Any Stock distributed pursuant to an Award may consist, in whole or in part, of authorized and unissued Stock, treasury Stock or Stock purchased on the open market.

ARTICLE 4 ELIGIBILITY AND PARTICIPATION

4.1 Eligibility.

(a) **General.** Awards may be granted only to Eligible Participants. All Options granted under the Plan shall be Non-Qualified Stock Options.

(b) **Foreign Participants.** In order to assure the viability of Awards granted to Participants employed in foreign countries, the Committee may provide for such special terms as it may consider necessary or appropriate to accommodate differences in local law, tax policy, or custom. Moreover, the Committee may approve such supplements to, or amendments, restatements, or alternative versions of, the Plan as it may consider necessary or appropriate for such purposes without thereby affecting the terms of the Plan as in effect for any other purpose; *provided, however*, that no such supplements, amendments, restatements, or alternative versions shall increase the share limitations contained in Sections 3.1 of the Plan.

4.2 Actual Participation. Subject to the provisions of the Plan, the Committee may, from time to time, select from among all eligible individuals, those to whom Awards shall be granted and shall determine the nature and amount of each Award. No individual shall have any right to be granted an Award pursuant to the Plan.

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ARTICLE 5 STOCK OPTIONS

5.1 General. Options may be granted to Eligible Participants on the following terms and conditions:

(a) **Exercise Price.** The exercise price per share of Stock subject to an Option shall be determined by the Committee and set forth in the Award Agreement; *provided* that the exercise price for any Option shall not be less than Fair Market Value of a share of Stock on the date of grant.

(b) **Time And Conditions Of Exercise.** The Committee shall determine the time or times at which an Option may be exercised in whole or in part; *provided*, that the term of any Option granted under the Plan shall not exceed ten years; and *provided, further*, that such Option shall be exercisable for not less than one year after the date of the Participant's death. The Committee shall also determine the performance or other conditions, if any, that must be satisfied before all or part of an Option may be exercised.

(c) **Payment.** The Committee shall determine the methods by which the exercise price of an Option may be paid, the form of payment, including, without limitation, cash, promissory note bearing interest at no less than such rate as shall then preclude the imputation of interest under the Code, shares of Stock held for longer than six months having a Fair Market Value on the date of delivery equal to the aggregate exercise price of the Option or exercised portion thereof, or other property acceptable to the Committee (including through the delivery of a notice that the Participant has placed a market sell order with a broker with respect to shares of Stock then issuable upon exercise of the Option, and that the broker has been directed to pay a sufficient portion of the net proceeds of the sale to the Company in satisfaction of the Option exercise price; *provided*, that payment of such proceeds is then made to the Company upon settlement of such sale), and the methods by which shares of Stock shall be delivered or deemed to be delivered to Participants. Notwithstanding any other provision of the Plan to the contrary, no Participant who is a member of the Board or an "executive officer" of the Company within the meaning of Section 13(k) of the Exchange Act shall be permitted to pay the exercise price of an Option in any method which would violate Section 13(k).

(d) **Evidence Of Grant.** All Options shall be evidenced by a written Award Agreement between the Company and the Participant. The Award Agreement shall include such additional provisions as may be specified by the Committee.

ARTICLE 6 RESTRICTED STOCK AWARDS

6.1 Grant of Restricted Stock. Restricted Stock may be awarded to any Eligible Participant in such amounts and subject to such terms and conditions as determined by the Committee. All Awards of Restricted Stock shall be evidenced by a written Restricted Stock Award Agreement.

6.2 Issuance and Restrictions. Restricted Stock shall be subject to such restrictions on transferability and other restrictions as the Committee may impose (including, without limitation,

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limitations on the right to vote Restricted Stock or the right to receive dividends on the Restricted Stock). These restrictions may lapse separately or in combination at such times, pursuant to such circumstances, in such installments, or otherwise, as the Committee determines at the time of the grant of the Award or thereafter.

6.3 Forfeiture. Except as otherwise determined by the Committee at the time of the grant of the Award or thereafter, upon termination of employment or service during the applicable restriction period, Restricted Stock that is at that time subject to restrictions shall be forfeited; *provided, however*, that the Committee may provide in any Restricted Stock Award Agreement that restrictions or forfeiture conditions relating to Restricted Stock will be waived in whole or in part in the event of terminations resulting from specified causes, and the Committee may in other cases waive in whole or in part restrictions or forfeiture conditions relating to Restricted Stock.

6.4 Certificates For Restricted Stock. Restricted Stock granted pursuant to the Plan may be evidenced in such manner as the Committee shall determine. If certificates representing shares of Restricted Stock are registered in the name of the Participant, certificates must bear an appropriate legend referring to the terms, conditions, and restrictions applicable to such Restricted Stock, and the Company may, at its discretion, retain physical possession of the certificate until such time as all applicable restrictions lapse.

ARTICLE 7

STOCK APPRECIATION RIGHTS

7.1 Grant of Stock Appreciation Rights. A Stock Appreciation Right may be granted to any Eligible Participant selected by the Committee. A Stock Appreciation Right may be granted (a) in connection and simultaneously with the grant of an Option, (b) with respect to a previously granted Option, or (c) independent of an Option. A Stock Appreciation Right shall be subject to such terms and conditions not inconsistent with the Plan as the Committee shall impose and shall be evidenced by an Award Agreement.

7.2 Coupled Stock Appreciation Rights.

(a) A Coupled Stock Appreciation Right (“**CSAR**”) shall be related to a particular Option and shall be exercisable only when and to the extent the related Option is exercisable.

(b) A CSAR may be granted to a Participant for no more than the number of shares subject to the simultaneously or previously granted Option to which it is coupled.

(c) A CSAR shall entitle the Participant (or other person entitled to exercise the Option pursuant to the Plan) to surrender to the Company unexercised a portion of the Option to which the CSAR relates (to the extent then exercisable pursuant to its terms) and to receive from the Company in exchange therefor an amount determined by multiplying the difference obtained by subtracting the Option exercise price from the Fair Market Value of a share of Stock on the date of exercise of the CSAR by the number of shares of Stock with respect to which the CSAR shall have been exercised, subject to any limitations the Committee may impose.

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7.3 Independent Stock Appreciation Rights.

(a) An Independent Stock Appreciation Right (“**ISAR**”) shall be unrelated to any Option and shall have a term set by the Committee. An ISAR shall be exercisable in such installments as the Committee may determine. An ISAR shall cover such number of shares of Stock as the Committee may determine. The exercise price per share of Stock subject to each ISAR shall be set by the Committee; *provided, however*, that, the Committee in its sole and absolute discretion may provide that the ISAR may be exercised subsequent to a termination of employment or service, as applicable, or following a Change of Control, or because of the Participant’s retirement, death or Disability, or otherwise.

(b) An ISAR shall entitle the Participant (or other person entitled to exercise the ISAR pursuant to the Plan) to exercise all or a specified portion of the ISAR (to the extent then exercisable pursuant to its terms) and to receive from the Company an amount determined by multiplying the difference obtained by subtracting the exercise price per share of the ISAR from the Fair Market Value of a share of Stock on the date of exercise of the ISAR by the number of shares of Stock with respect to which the ISAR shall have been exercised, subject to any limitations the Committee may impose.

7.4 Payment and Limitations on Exercise.

(a) Payment of the amounts determined under Section 7.2(c) and 7.3(b) above shall be in cash, in Stock (based on its Fair Market Value as of the date the Stock Appreciation Right is exercised) or a combination of both, as determined by the Committee.

(b) To the extent any payment under Section 7.2(c) or 7.3(b) is effected in Stock it shall be made subject to satisfaction of all provisions of Article 5 above pertaining to Options.

ARTICLE 8

OTHER TYPES OF AWARDS

8.1 Performance Share Awards. Any Eligible Participant selected by the Committee may be granted one or more Performance Share awards which may be denominated in a number of shares of Stock or in a dollar value of shares of Stock and which may be linked to any one or more specific performance criteria determined appropriate by the Committee, in each case on a specified date or dates or over any period or periods determined by the Committee. In making such determinations, the Committee shall consider (among such other factors as it deems relevant in light of the specific type of award) the contributions, responsibilities and other compensation of the particular Participant.

8.2 Dividend Equivalents. Any Eligible Participant selected by the Committee may be granted Dividend Equivalents based on the dividends declared on the shares of Stock that are subject to any Award, to be credited as of dividend payment dates, during the period between the date the Award is

granted and the date the Award is exercised, vests or expires, as determined by the Committee. Such Dividend Equivalents shall be converted to cash or additional shares of

Stock by such formula and at such time and subject to such limitations as may be determined by the Committee.

8.3 Stock Payments. Any Eligible Participant selected by the Committee may receive Stock Payments in the manner determined from time to time by the Committee. The number of shares shall be determined by the Committee and may be based upon specific performance criteria determined appropriate by the Committee, determined on the date such Stock Payment is made or on any date thereafter.

8.4 Restricted Stock Units. Any Eligible Participant selected by the Committee may be granted an award of Restricted Stock Units in the manner determined from time to time by the Committee. The number of Restricted Stock Units shall be determined by the Committee and may be linked to the Performance Criteria or other specific performance criteria determined to be appropriate by the Committee, in each case on a specified date or dates or over any period or periods determined by the Committee. Stock underlying a Restricted Stock Unit award will not be issued until the Restricted Stock Unit award has vested, pursuant to a vesting schedule or performance criteria set by the Committee. Unless otherwise provided by the Committee, a Participant awarded Restricted Stock Units shall have no rights as a Company stockholder with respect to such Restricted Stock Units until such time as the Restricted Stock Units have vested and the Stock underlying the Restricted Stock Units has been issued.

8.5 Term. The term of any Award of Performance Shares, Dividend Equivalents, Stock Payments or Restricted Stock Units shall be set by the Committee in its discretion.

8.6 Exercise or Purchase Price. The Committee may establish the exercise or purchase price of any Award of Performance Shares, Restricted Stock Units or Stock Payments; provided, however, that such price shall not be less than the par value of a share of Stock, unless otherwise permitted by applicable state law.

8.7 Exercise Upon Termination of Employment or Service. An Award of Performance Shares, Dividend Equivalents, Restricted Stock Units and Stock Payments shall only be exercisable or payable while the Participant is an Employee or Director of the Company or a Subsidiary; *provided, however*, that the Committee in its sole and absolute discretion may provide that an Award of Performance Shares, Dividend Equivalents, Stock Payments or Restricted Stock Units may be exercised or paid subsequent to a termination of employment or service, as applicable, or following a Change of Control, or because of the Participant's retirement, death or Disability, or otherwise.

8.8 Form of Payment. Payments with respect to any Awards granted under this Article 8 shall be made in cash, in Stock or a combination of both, as determined by the Committee.

8.9 Award Agreement. All Awards under this Article 8 shall be subject to such additional terms and conditions as determined by the Committee and shall be evidenced by a written Award Agreement.

ARTICLE 9 PROVISIONS APPLICABLE TO AWARDS

9.1 Stand-Alone and Tandem Awards. Awards granted pursuant to the Plan may, in the discretion of the Committee, be granted either alone, in addition to, or in tandem with, any other Award granted pursuant to the Plan. Awards granted in addition to or in tandem with other Awards may be granted either at the same time as or at a different time from the grant of such other Awards.

9.2 Award Agreement. Awards under the Plan shall be evidenced by Award Agreements that set forth the terms, conditions and limitations for each Award which may include the term of an Award, the provisions applicable in the event the Participant's employment or service terminates, and the Company's authority to unilaterally or bilaterally amend, modify, suspend, cancel or rescind an Award.

9.3 Limits on Transfer. No right or interest of a Participant in any Award may be pledged, encumbered, or hypothecated to or in favor of any party other than the Company or a Subsidiary, or shall be subject to any lien, obligation, or liability of such Participant to any other party other than the Company or a Subsidiary. No Award shall be assigned, transferred, or otherwise disposed of by a Participant other than by will or the laws of descent and distribution.

9.4 Beneficiaries. Notwithstanding Section 9.3, a Participant may, in the manner determined by the Committee, designate a beneficiary to exercise the rights of the Participant and to receive any distribution with respect to any Award upon the Participant's death. A beneficiary, legal guardian, legal representative, or other person claiming any rights pursuant to the Plan is subject to all terms and conditions of the Plan and any Award Agreement applicable to the Participant, except to the extent the Plan and Award Agreement otherwise provide, and to any additional restrictions deemed necessary or appropriate by the Committee. If the Participant is married and resides in a community property state, a designation of a person other than the Participant's spouse as his beneficiary with respect to more than 50% of the Participant's interest in the Award shall not be effective without the prior written consent of the Participant's spouse. If no beneficiary has been designated or survives the Participant, payment shall be made to the person entitled thereto pursuant to the Participant's will or the laws of descent and distribution. Subject to the foregoing, a beneficiary designation may be changed or revoked by a Participant at any time provided the change or revocation is filed with the Committee.

9.5 Stock Certificates. Notwithstanding anything herein to the contrary, the Company shall not be required to issue or deliver any certificates evidencing shares of Stock pursuant to the exercise of any Award, unless and until the Board has determined, with advice of counsel, that the issuance and

delivery of such certificates is in compliance with all applicable laws, regulations of governmental authorities and, if applicable, the requirements of any exchange on which the shares of Stock are listed or traded. All Stock certificates delivered pursuant to the Plan are subject to any stop-transfer orders and other restrictions as the Committee deems necessary or advisable to comply with federal, state, or foreign jurisdiction, securities or other laws, rules and regulations and the rules of any national securities exchange or automated quotation system on which the Stock is listed, quoted, or traded. The Committee may place legends on any Stock certificate to reference restrictions applicable to the Stock. In addition to the terms and conditions provided herein, the Board may require that a Participant make such

reasonable covenants, agreements, and representations as the Board, in its discretion, deems advisable in order to comply with any such laws, regulations, or requirements. The Committee shall have the right to require any Participant to comply with any timing or other restrictions with respect to the settlement or exercise of any Award, including a window-period limitation, as may be imposed in the discretion of the Committee.

ARTICLE 10 CHANGES IN CAPITAL STRUCTURE

10.1 Adjustments. In the event of any stock dividend, stock split, combination or exchange of shares, merger, consolidation, spin-off, recapitalization or other distribution (other than normal cash dividends) of Company assets to stockholders, or any other change affecting the shares of Stock or the share price of the Stock, the Committee shall make such proportionate adjustments, if any, as the Committee in its discretion may deem appropriate to reflect such change with respect to (i) the aggregate number and type of shares that may be issued under the Plan (including, but not limited to, adjustments of the limitations in Sections 3.1); (ii) the terms and conditions of any outstanding Awards (including, without limitation, any applicable performance targets or criteria with respect thereto); and (iii) the grant or exercise price per share for any outstanding Awards under the Plan.

10.2 Effect of a Change of Control When Awards Are Not Assumed. If a Change of Control occurs and a Participant's Awards are not assumed by the surviving or successor entity or its parent or Subsidiary and such successor does not substitute substantially similar awards for those outstanding under the Plan, such Awards shall become fully exercisable and/or payable as applicable, and all forfeiture restrictions on such Awards shall lapse. Upon, or in anticipation of, a Change of Control, the Committee may cause any and all Awards outstanding hereunder to terminate at a specific time in the future and shall give each Participant the right to exercise such Awards during a period of time as the Committee, in its sole and absolute discretion, shall determine. The Committee shall have sole discretion to determine whether an Award has been assumed by the surviving or successor entity or its parent or Subsidiary or whether such successor has substituted substantially similar awards for those outstanding under the Plan in connection with a Change of Control.

10.3 Effect of Change of Control When Awards Are Assumed; Termination Following Change of Control.

(a) In the event of a Change of Control where a Participant's Awards are assumed by the surviving or successor entity or its parent or Subsidiary or such successor substitutes substantially similar awards for those outstanding under the Plan, then fifty percent (50%) of such Participant's unvested Awards shall become fully exercisable and/or payable as applicable, and all forfeiture restrictions on such Awards shall lapse, immediately prior to such Change of Control.

(b) In the event of a Change of Control where a Participant's Awards are assumed by the surviving or successor entity or its parent or Subsidiary or such successor substitutes substantially similar awards for those outstanding under the Plan, if within twelve (12) months following such Change of Control (i) the Participant's employment or service with

the surviving or successor entity or its parent or Subsidiary is terminated without Cause or (ii) such Participant voluntarily terminates such Participant's employment or service with Good Reason, then such Participant's remaining unvested Awards (including any substituted awards) shall become fully exercisable and/or payable as applicable, and all forfeiture restrictions on such Awards (including any substituted awards) shall lapse, on the date of termination. Such Awards (including any substituted awards) shall remain exercisable, as applicable, until the earlier of the expiration date of the Award or three (3) months following such Participant's cessation of employment or service.

10.4 Outstanding Awards — Certain Mergers. Subject to any required action by the stockholders of the Company, in the event that the Company shall be the surviving corporation in any merger or consolidation (except a merger or consolidation as a result of which the holders of shares of Stock receive securities of another corporation), each Award outstanding on the date of such merger or consolidation shall pertain to and apply to the securities that a holder of the number of shares of Stock subject to such Award would have received in such merger or consolidation.

10.5 Outstanding Awards — Other Changes. In the event of any other change in the capitalization of the Company or corporate change other than those specifically referred to in this Article 10, the Committee may, in its absolute discretion, make such adjustments in the number and class of shares subject to Awards outstanding on the date on which such change occurs and in the per share grant or exercise price of each Award as the Committee may consider appropriate to prevent dilution or enlargement of rights.

10.6 No Other Rights. Except as expressly provided in the Plan, no Participant shall have any rights by reason of any subdivision or consolidation of shares of stock of any class, the payment of any dividend, any increase or decrease in the number of shares of stock of any class or any dissolution, liquidation, merger, or consolidation of the Company or any other corporation. Except as expressly provided in the Plan or pursuant to action of the Committee under the Plan, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number of shares of Stock subject to an Award or the grant or exercise price of any Award.

ARTICLE 11 ADMINISTRATION

11.1 Committee. Unless and until the Board delegates administration to the Committee as set forth below, the Plan shall be administered by the Board, which shall, in such event, constitute the “Committee” for the purposes of the Plan. Any action taken by the Board in connection with the administration of the Plan shall not be deemed approved by the Board unless such actions are approved by a majority of the Independent Directors. The Board may delegate administration of the Plan to the Committee, and the term “Committee” shall apply to any person or persons to whom such authority has been delegated; *provided, however*, that such Committee be comprised of a majority of or solely two or more Independent Directors. If administration is delegated to a Committee, the Committee shall have, in connection with the administration of the Plan, the powers theretofore possessed by the Board, including the power to delegate to a

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subcommittee any of the administrative powers the Committee is authorized to exercise (and references in the Plan to the Board shall thereafter be to the Committee or subcommittee), subject, however, to such resolutions, not inconsistent with the provisions of the Plan, as may be adopted from time to time by the Board.

The Board may abolish the Committee at any time and revest in the Board the administration of the Plan. Any action taken by the Board in connection with the administration of the Plan shall continue to not be deemed approved by the Board unless such actions are approved by a majority of the Independent Directors. Appointment of Committee members shall be effective upon acceptance of appointment. Committee members may resign at any time by delivering written notice to the Board. Vacancies in the Committee may only be filled by the Board.

11.2 Action by the Committee. A majority of the Committee shall constitute a quorum. The acts of a majority of the members present at any meeting at which a quorum is present, and acts approved in writing by a majority of the Committee in lieu of a meeting, shall be deemed the acts of the Committee. Each member of the Committee is entitled to, in good faith, rely or act upon any report or other information furnished to that member by any officer or other employee of the Company or any Subsidiary, the Company’s independent certified public accountants, or any executive compensation consultant or other professional retained by the Company to assist in the administration of the Plan.

11.3 Authority of Committee. Subject to any specific designation in the Plan, the Committee has the exclusive power, authority and discretion to:

(a) Adopt procedures from time to time in the Committee’s discretion to ensure that an Employee is eligible to participate in the Plan prior to the granting of any Awards to such Employee under the Plan (including, without limitation, a requirement, if any, that each such Employee certify to the Company prior to the receipt of an Award under the Plan that he or she has not been previously employed by the Company or a Subsidiary, or if previously employed, has had a bona fide period of non-employment, and that the grant of Awards under the Plan is an inducement material to his or her agreement to enter into employment with the Company or a Subsidiary);

(b) Designate Participants to receive Awards;

(c) Determine the type or types of Awards to be granted to each Participant;

(d) Determine the number of Awards to be granted and the number of shares of Stock to which an Award will relate;

(e) Determine the terms and conditions of any Award granted pursuant to the Plan, including, but not limited to, the exercise price, grant price, or purchase price, any reload provision, any restrictions or limitations on the Award, any schedule for lapse of forfeiture restrictions or restrictions on the exercisability of an Award, and accelerations or waivers thereof, any provisions related to non-competition and recapture of gain on an Award, based in each case on such considerations as the Committee in its sole discretion determines;

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(f) Determine whether, to what extent, and pursuant to what circumstances an Award may be settled in, or the exercise price of an Award may be paid in cash, Stock, other Awards, or other property, or an Award may be canceled, forfeited, or surrendered;

(g) Prescribe the form of each Award Agreement, which need not be identical for each Participant;

(h) Decide all other matters that must be determined in connection with an Award;

(i) Establish, adopt, or revise any rules and regulations as it may deem necessary or advisable to administer the Plan;

(j) Interpret the terms of, and any matter arising pursuant to, the Plan or any Award Agreement; and

(k) Make all other decisions and determinations that may be required pursuant to the Plan or as the Committee deems necessary or advisable to administer the Plan.

12.4 Decisions Binding. The Committee’s interpretation of the Plan, any Awards granted pursuant to the Plan, any Award Agreement and all decisions and determinations by the Committee with respect to the Plan are final, binding, and conclusive on all parties.

ARTICLE 12 EFFECTIVE AND EXPIRATION DATE

12.1 Effective Date. The Plan is effective as of the date of its adoption by the Board (the “**Effective Date**”).

12.2 Expiration Date. The Plan will expire on, and no Award may be granted pursuant to the Plan after December 31, 2015 (the “Expiration Date”). Any Awards that are outstanding on the Expiration Date shall remain in force according to the terms of the Plan and the applicable Award Agreement. Each Award Agreement shall provide that it will expire on the tenth anniversary of the date of grant of the Award to which it relates.

ARTICLE 13 AMENDMENT, MODIFICATION, AND TERMINATION

13.1 Amendment, Modification, and Termination. With the approval of the Board, at any time and from time to time, the Committee may terminate, amend or modify the Plan; *provided, however*, that to the extent necessary and desirable to comply with any applicable law, regulation, or stock exchange rule, the Company shall obtain stockholder approval of any Plan amendment in such a manner and to such a degree as required.

13.2 Awards Previously Granted. No termination, amendment, or modification of the Plan shall adversely affect in any material way any Award previously granted pursuant to the Plan without the prior written consent of the Participant.

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ARTICLE 14 GENERAL PROVISIONS

14.1 No Rights to Awards. No Participant, employee, or other person shall have any claim to be granted any Award pursuant to the Plan, and neither the Company nor the Committee is obligated to treat Participants, employees, and other persons uniformly.

14.2 No Stockholders Rights. No Award gives the Participant any of the rights of a stockholder of the Company unless and until shares of Stock are in fact issued to such person in connection with such Award.

14.3 Withholding. The Company or any Subsidiary shall have the authority and the right to deduct or withhold, or require a Participant to remit to the Company, an amount sufficient to satisfy federal, state, local and foreign taxes (including the Participant’s FICA obligation) required by law to be withheld with respect to any taxable event concerning a Participant arising as a result of the Plan. The Committee may in its discretion and in satisfaction of the foregoing requirement allow a Participant to elect to have the Company withhold shares of Stock otherwise issuable under an Award (or allow the return of shares of Stock) having a Fair Market Value equal to the sums required to be withheld. Notwithstanding any other provision of the Plan, the number of shares of Stock which may be withheld with respect to the issuance, vesting, exercise or payment of any Award (or which may be repurchased from the Participant of such Award within six months after such shares of Stock were acquired by the Participant from the Company) in order to satisfy the Participant’s federal, state, local and foreign income and payroll tax liabilities with respect to the issuance, vesting, exercise or payment of the Award shall be limited to the number of shares which have a Fair Market Value on the date of withholding or repurchase equal to the aggregate amount of such liabilities based on the minimum statutory withholding rates for federal, state, local and foreign income tax and payroll tax purposes that are applicable to such supplemental taxable income.

14.4 No Right to Employment or Services. Nothing in the Plan or any Award Agreement shall interfere with or limit in any way the right of the Company or any Subsidiary to terminate any Participant’s employment or services at any time, nor confer upon any Participant any right to continue in the employ or service of the Company or any Subsidiary.

14.5 Unfunded Status of Awards. The Plan is intended to be an “unfunded” plan for incentive compensation. With respect to any payments not yet made to a Participant pursuant to an Award, nothing contained in the Plan or any Award Agreement shall give the Participant any rights that are greater than those of a general creditor of the Company or any Subsidiary.

14.6 Indemnification. To the extent allowable pursuant to applicable law, each member of the Committee or of the Board shall be indemnified and held harmless by the Company from any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by such member in connection with or resulting from any claim, action, suit, or proceeding to which he or she may be a party or in which he or she may be involved by reason of any action or failure to act pursuant to the Plan and against and from any and all amounts paid by him or her in satisfaction of judgment in such action, suit, or proceeding against him or her; *provided*, he or she gives the Company an opportunity, at its own expense, to handle and defend

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the same before he or she undertakes to handle and defend it on his or her own behalf. The foregoing right of indemnification shall not be exclusive of any other rights of indemnification to which such persons may be entitled pursuant to the Company’s Certificate of Incorporation or Bylaws, as a matter of law, or otherwise, or any power that the Company may have to indemnify them or hold them harmless.

14.7 Relationship to Other Benefits. No payment pursuant to the Plan shall be taken into account in determining any benefits pursuant to any pension, retirement, savings, profit sharing, group insurance, welfare or other benefit plan of the Company or any Subsidiary except to the extent otherwise expressly provided in writing in such other plan or an agreement thereunder.

14.8 Expenses. The expenses of administering the Plan shall be borne by the Company and its Subsidiaries.

14.9 Titles and Headings. The titles and headings of the Articles and Sections in the Plan are for convenience of reference only and, in the event of any conflict, the text of the Plan, rather than such titles or headings, shall control.

14.10 Fractional Shares. No fractional shares of Stock shall be issued and the Committee shall determine, in its discretion, whether cash shall be given in lieu of fractional shares or whether such fractional shares shall be eliminated by rounding up or down as appropriate.

14.11 Limitations Applicable to Section 16 Persons. Notwithstanding any other provision of the Plan, the Plan, and any Award granted or awarded to any Participant who is then subject to Section 16 of the Exchange Act, shall be subject to any additional limitations set forth in any applicable exemptive rule under Section 16 of the Exchange Act (including any amendment to Rule 16b-3 of the Exchange Act) that are requirements for the application of such exemptive rule. To the extent permitted by applicable law, the Plan and Awards granted or awarded hereunder shall be deemed amended to the extent necessary to conform to such applicable exemptive rule.

14.12 Government And Other Regulations. The obligation of the Company to make payment of awards in Stock or otherwise shall be subject to all applicable laws, rules, and regulations, and to such approvals by government agencies as may be required. The Company shall be under no obligation to register pursuant to the Securities Act of 1933, as amended, any of the shares of Stock paid pursuant to the Plan. If the shares paid pursuant to the Plan may in certain circumstances be exempt from registration pursuant to the Securities Act of 1933, as amended, the Company may restrict the transfer of such shares in such manner as it deems advisable to ensure the availability of any such exemption.

14.13 Governing Law. The Plan and all Award Agreements shall be construed in accordance with and governed by the laws of the State of Delaware.

14.14 SECTION 409A OF THE CODE. In the event any provision of the Plan, or the application thereof, is or becomes inconsistent with Section 409A of the Code and any regulations promulgated thereunder, such provision shall be void or unenforceable or in the sole

discretion of the Committee shall be deemed amended to comply with Section 409A and any regulations promulgated thereunder. The other provisions of the Plan shall remain in full force and effect.

ARTICLE 15 GENERAL PROVISIONS

15.1 STOCKHOLDER APPROVAL NOT REQUIRED. It is expressly intended that approval of the Company's stockholders not be required as a condition of the effectiveness of the Plan, and the Plan's provisions shall be interpreted in a manner consistent with such intent for all purposes. Specifically, Rule 4350(i) promulgated by the NASD generally requires stockholder approval for stock option plans or other equity compensation arrangements adopted by companies whose securities are listed on the Nasdaq National Market pursuant to which stock awards or stock may be acquired by officers, directors, employees, or consultants of such companies. NASD Rule 4350(i)(1)(A)(iv) provides an exception to this requirement for issuances of securities to a person not previously an employee or director of the issuer, or following a bona fide period of non-employment, as an inducement material to the individual's entering into employment with the issuer; *provided*, such issuances are approved by either the issuer's compensation committee comprised of a majority of independent directors or a majority of the issuer's independent directors. Awards under the Plan may only be made to Eligible Participants who have not previously been an Employee or director of the Company or a Subsidiary, or following a bona fide period of non-employment by the Company or a Subsidiary, as an inducement material to the Eligible Participant's entering into employment with the Company or a Subsidiary. Awards under the Plan will be approved by (i) the Company's Compensation Committee comprised of a majority of the Company's Independent Directors or (ii) a majority of the Company's Independent Directors. Accordingly, pursuant to NASD Rule 4350(i)(1)(A)(iv), the issuance of Awards and the shares of Common Stock issuable upon exercise or vesting of such Awards pursuant to the Plan are not subject to the approval of the Company's stockholders.

COMMERCIAL SUBLEASE AGREEMENT

This Sublease Agreement (“Sublease”) is entered as of December , 2006 by and between a Delaware limited partnership (“Sublandlord”) and Sunesis Pharmaceuticals, Inc., a Delaware corporation (“Subtenant”). Sublandlord and Subtenant may individually be referred to as a “Party” or collectively as the “Parties.”

RECITALS

WHEREAS, Sublandlord entered into a lease agreement dated June 1, 2003 and subsequently amended on December 15, 2004 and March 1, 2005, between the Sublandlord and (“Master Landlord”) for space located at 395 Oyster Point Blvd., South San Francisco, CA (the “Master Premises”) and for a term ending on February 28, 2014 (the “Master Lease Agreement”); and

WHEREAS, Subject to the Master Landlord’s consent, Sublandlord and Subtenant wish to enter into this Sublease for a portion of the Master Premises.

NOW, THEREFORE, the Parties agree as follows:

1. **RECITALS:** The Recitals are incorporated herein in their entirety.
2. **PREMISES:** Sublandlord hereby subleases to Subtenant the Premises located at: 395 Oyster Point Marina Plaza, 395 Oyster Point Blvd., South San Francisco, California 94080. The subleased premises consist of those 15,378 rentable square feet of the Master Premises located on the 4th floor (Suites 400, 401 and 402) as shown on the floor plan attached hereto as Exhibit A (collectively, the “Premises”). Subtenant hereby subleases the Premises from Sublandlord for the term and rental and upon the other terms and conditions hereinafter set forth, to be used and occupied by Subtenant solely for the purpose of office space and for no other purpose.
3. **SUBLEASE TERM:** The term of the Sublease will be for a period of seventy four (74) months, beginning on February 1, 2007 (begin date) and ending on March 31, 2013 (end date) (the “Sublease Term”).
4. **OPTION TO RENEW:** Subtenant shall have one (1) option to renew this Sublease on the Sublease Premises for the balance of the Master Lease term expiring February 28, 2014. Subtenant must exercise this option by providing written notice to Sublandlord at least 9 (nine) months prior to the end of the Sublease Term. The Base Rent for the option period shall be fixed at \$2.25 per square foot.
5. **SUBLEASE COMMENCEMENT:** The Sublease Commencement Date shall be February 1, 2007. Possession of the Premises shall be delivered to Subtenant no later than December , 2006, in order for Subtenant to complete its planned improvements (the “Early Occupancy”). Subtenant occupancy shall occur no earlier than January 15, 2007. Subtenant shall be subject to all of the terms of this Sublease during the Early Occupancy, except for the

obligation to pay Base Rent. In the event that the possession of the Premises is not delivered to Subtenant on or before December , 2006, Subtenant’s obligation to pay Base Rent as of the Sublease Commencement Date shall be abated one day for each day such delay continues past December , 2006.

6. **LEASE PAYMENT AMOUNTS:** Subtenant agrees to pay to Sublandlord as rent for the Premises the amounts shown on the following rent schedule:

Months	Base Rent/Square Foot/Month (Fully Serviced)	
1 — 3	Base Rent Abated	
4 — 12	\$	1.95 FS
13 — 24	\$	2.00 FS
25 — 36	\$	2.05 FS
37 — 48	\$	2.10 FS
49 — 60	\$	2.15 FS
61 — 74	\$	2.20 FS

7. **PAYMENT:** Upon Sublease execution, Subtenant will provide Sublandlord with the fourth month’s payable base rent, evidence of required insurance coverage and a security deposit as described in Section 13. Thereafter, Subtenant agrees to pay Sublandlord each month in advance on the first day of each month at: 395 Oyster Point Blvd. Suite _____, South San Francisco, CA 94080 (address for rent payment), or at any other address designated by Sublandlord. All payments due from Subtenant to Sublandlord hereunder shall be made to Sublandlord without deduction or offset whatsoever, in lawful money of the United States of America at the address for payment set forth in the Basic Lease Information, or to such other person or at such other place as Sublandlord may from time to time designate by notice to Subtenant.

Sublandlord hereby acknowledges that Sublandlord’s failure to pay the rent and other sums owing by Sublandlord to Master Landlord under the Master Lease Agreement will cause Subtenant to incur damages, costs and expenses not contemplated by this Sublease, especially in those cases where Subtenant has paid sums to Sublandlord hereunder which correspond in whole or in part to the amounts owing by Sublandlord to Master Landlord under the Master Lease Agreement. Accordingly, Subtenant shall have the right to pay all rent and other sums owing by

Subtenant to Sublandlord hereunder for those items which also are owed by Sublandlord to Master Landlord under the Master Lease Agreement directly to Master Landlord on the following terms and conditions:

- (a) Either (i) Subtenant reasonably believes that Sublandlord has failed to make any payment required to be made by Sublandlord to Master Landlord under the Master Lease Agreement and Sublandlord fails to provide adequate proof of payment within two (2) business days after Subtenant's written demand requesting such proof; or (ii) Subtenant reasonably believes that Sublandlord shall fail to make any payment required to be made by Sublandlord to Master Landlord under the Master Lease Agreement and Sublandlord fails to provide assurance of future performance in form reasonably satisfactory to Subtenant within two (2) business days after Subtenant's written demand requesting such assurance.
- (b) Subtenant shall not prepay any amounts owing by Sublandlord without the consent of Sublandlord.
- (c) Subtenant shall provide to Sublandlord concurrently with any payment to Master Landlord reasonable evidence of such payment.
- (d) If Sublandlord notifies Subtenant that it disputes any amount demanded by Master Landlord, Subtenant shall not make any such payment to Master Landlord unless Master Landlord has provided a three-day notice to pay such amount or forfeit the Master Lease Agreement.

Any sums paid directly by Subtenant to Master Landlord in accordance with this Section 7 shall be credited toward the amounts payable by Subtenant to Sublandlord under this Sublease. In the event Subtenant tenders payment directly to Master Landlord in accordance with this Section 7 and Master Landlord refuses to accept such payment, Subtenant shall have the right to deposit such funds in an account with a national bank for the benefit of Master Landlord and Subtenant, and the deposit of said funds in such account shall discharge Subtenant's obligation under this Sublease to make the payment in question.

8. LATE FEE: Subtenant hereby acknowledges that late payment by Subtenant to Sublandlord of rent and other amounts due hereunder will cause Sublandlord 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 on Sublandlord by the terms of the Master Lease Agreement. Accordingly, if any installment of rent or any other sums due from Subtenant shall not be received by Sublandlord within ten (10) days following the date due, Subtenant shall pay to Sublandlord a late charge equal to one percent (1%) of such overdue amount. The parties hereby agree that such late charge represents a fair and reasonable estimate of the costs Sublandlord will incur by reason of late payment by Subtenant. Acceptance of such late charge by Sublandlord shall in no event constitute a waiver of Subtenant's default with respect to such overdue amount, nor prevent Sublandlord from exercising any of the other rights and remedies granted hereunder.

9. INSUFFICIENT FUNDS: Subtenant agrees to pay the charge of \$150 for each check that is returned for lack of sufficient funds.

10. OPERATING EXPENSES AND PROPERTY TAXES: The Sublease shall be full service in nature. Subtenant shall be responsible for its Pro-Rata Share of building operating expenses without mark-up, including real estate taxes and real estate tax increases over and above the 2007 Base Year, but only to the extent such expenses apply to the term of the Sublease, are chargeable to Subtenant and the Premises pursuant to Section 4.2 of the Master Lease Agreement, as incorporated herein, and are equitably allocable to Subtenant (excluding, by way of example, charges caused solely by Sublandlord or its employees). Prior to Sublease execution, Sublandlord will provide Subtenant with the last three years' Operating Expenses and with the 2006 projected operating expenses. For purposes of this Sublease, "Operating Expenses" shall have the same meaning as that described in the Master Lease Agreement. For purposes of this Sublease, Pro-Rata Share shall mean _____ %.

11. SUBTENANT IMPROVEMENTS: In lieu of providing Subtenant with a subtenant improvement allowance, Sublandlord has agreed to abate the first three installments of monthly base rent due hereunder.

12. BUSINESS TAXES: Subtenant shall pay all business and other taxes (unrelated to Sublandlord's or Master Landlord's income or revenue), if any, in respect of the business carried on in or upon the Premises.

13. SECURITY DEPOSIT: At the signing of this Sublease, Subtenant shall deposit with Sublandlord, in trust, a security deposit of \$59,974.20 as security for the performance by Subtenant of the terms under this Sublease and for any damages caused by Subtenant, its employees, agents or visitors to the Premises during the Sublease Term. However, Subtenant's liability under this Sublease shall not be limited to the balance of the security deposit. Subtenant shall not apply or deduct any portion of any security deposit from the last or any month's rent. Subtenant shall not use or apply any such security deposit at any time in lieu of payment of rent. In the event of a default by Subtenant, Sublandlord may use or apply, as is reasonably necessary, all or any portion of the security deposit to cure such default of Subtenant. In such event, Subtenant shall restore the security deposit to its original amount, or one-half of its original amount, as applicable, within 10 business days of Landlord's written notice to do the same.

Provided Subtenant is not then in default of any of its obligations under the Sublease beyond applicable notice and cure periods, at the end of the 36th month of the Sublease Term, ½ (one-half) of the security deposit in the amount of \$29,987.10 shall be applied to Subtenant's payment of its rental obligation for the 37th month of the Sublease.

After the termination of the Sublease or any earlier termination of the Sublease, any remaining portion of the security deposit (including any interest) shall be returned to Subtenant in accordance with the provisions of § 1950.7 of the California Civil Code.

14. NON-DISTURBANCE; QUIET ENJOYMENT: Sublandlord agrees not to amend or modify the Master Lease Agreement in any way which increases Subtenant's obligations or adversely affects Subtenant's rights.

Subtenant shall be entitled to quiet enjoyment of the Premises during the Sublease Term, and neither Sublandlord nor Master Landlord will interfere with that right, as long as Subtenant pays the rent in a timely manner and performs all other obligations under this Sublease. In the event, however, that Sublandlord defaults in the performance or observance of any of Sublandlord's remaining obligations under the Master Lease Agreement or fails to perform Sublandlord's stated obligations under this Sublease, then Subtenant shall give Sublandlord notice specifying in what manner Sublandlord has defaulted, and if such default shall not be cured by Sublandlord within thirty (30) days thereafter (except that if such default cannot be cured within said thirty (30) day period, this period shall be extended for an additional reasonable time, provided that Sublandlord commences to cure such default within such thirty (30) day period and proceeds diligently thereafter to effect such cure as quickly as possible), then Subtenant shall be entitled to cure such default and promptly collect from Sublandlord Subtenant's reasonable expenses in so doing (including, without limitation, reasonable attorneys' fees and court costs), or, at Subtenant's option, to offset such reasonable expenses against all future payments of rent due under this Sublease. Subtenant shall not be required, however, to wait the entire cure period described herein if earlier action is required to comply with the Master Lease Agreement or with any applicable governmental law, regulation or order. Sublandlord shall promptly send to Subtenant copies of all notices and other communications it shall send to and receive from Master Landlord.

15. USE: Subtenant shall use the Premises only for professional and administrative general office use and as described in the Master Lease Agreement.

16. POSSESSION AND SURRENDER OF PREMISES: Subtenant shall be entitled to possession of the Premises on December , 2006, conditioned upon Subtenant meeting the insurance requirements outlined in Section 18 below and prior approval from the Master Landlord. At the expiration of the Sublease, Subtenant shall peaceably surrender the Premises to Sublandlord or Sublandlord's agent in the same condition it was in as of the Commencement Date, reasonable wear and tear, condemnation, casualty, and Hazardous Materials not released by Subtenant and items listed on Exhibit C, excepted.

17. CONDITION OF PREMISES: Sublandlord shall disclose actual knowledge of the existence of any underground storage tanks, sumps, piping and any other factor indicating the possible presence of Hazardous Materials in, on or around the Master Premises; any adverse present or contemplated use restrictions of the Premises; material physical defects; and any other material matter affecting its condition or value (collectively, the "Disclosure List"). A copy of the Disclosure List is attached hereto as Exhibit C.

Subtenant or Subtenant's agent has inspected the Premises, the fixtures, the grounds, building and improvements (limited to the electrical, HVAC and fire sprinkler systems, security and environmental aspects) and acknowledges that the Premises are in good and acceptable condition and suitable for Subtenant's intended use. If at any time during the term of this Sublease, in

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Subtenant's opinion, the conditions change, Subtenant shall promptly provide reasonable notice to Sublandlord.

Sublandlord shall indemnify Subtenant for all previously existing and non-Subtenant introduced Hazardous Materials on-site or within the structure. Additionally, Subtenant shall not be liable for any charges incurred, damage to the Premises, or any other fees or losses relating to any period prior to the Commencement Date. As used herein, "Hazardous Material" shall mean any material which is now or hereafter regulated by any governmental authority or which poses a hazard to the environment or human life.

18. OBLIGATIONS UNDER MASTER LEASE AGREEMENT: Sublandlord represents and warrants that: (i) the Master Lease Agreement is in full force and effect, (ii) Sublandlord is not in default under the Master Lease Agreement and, to Sublandlord's knowledge, Master Landlord is not in default thereunder, (iii) Sublandlord has previously furnished to Subtenant a true, accurate and complete copy of the Master Lease Agreement and all amendments thereto, and (iv) as of the date of this Sublease, the Sublandlord's leasehold estate is not encumbered by any deed of trust or mortgage financing.

Sublandlord shall fully perform all of its obligations under the Master Lease Agreement not assumed by Subtenant hereunder, including, without limitation, the prompt payment to Master Landlord paid by Subtenant to Sublandlord hereunder.

Sublandlord shall do either of the following with respect to the obligations of the Master Landlord under the Master Lease Agreement: (i) perform all such obligations, or (ii) use Sublandlord's diligent good faith efforts to cause Master Landlord to perform such obligations for the benefit of Subtenant. Such diligent good faith efforts shall include, without limitation: (a) upon Subtenant's written request, immediately notifying Master Landlord of its nonperformance under the Master Lease Agreement and requesting that Master Landlord perform its obligations under the Master Lease Agreement, and (b) permitting Subtenant to commence a lawsuit or other action in Subtenant's name to obtain the performance required from Master Landlord under the Master Lease Agreement; provided, however, that if Subtenant commences a lawsuit or other action, Subtenant shall pay all costs and expenses incurred in connection therewith, and Subtenant shall indemnify Sublandlord against, and hold Sublandlord harmless from, all reasonable costs and expenses incurred by Subtenant in connection therewith. Following a casualty, if this Sublease is not terminated, Sublandlord shall restore any improvements it installed in the Premises and the Sublandlord's property to the extent such restoration is not the responsibility of Master Landlord under the Master Lease Agreement. To the extent Sublandlord is required to insure any improvements to the Premises pursuant to the Master Lease Agreement, Sublandlord shall continue to insure such improvements as a requirement under this Sublease.

This Sublease and all rights of Subtenant hereunder and with respect to the Premises are subject to the terms, conditions and provisions of the Master Lease Agreement, except as otherwise provided herein. Except as otherwise specifically provided in this Sublease, Subtenant shall be entitled during the Sublease Term to receive all services, utilities, repairs and facilities which Master Landlord is required to provide pursuant to the terms of the Master Lease Agreement insofar as such services, utilities, repairs and facilities pertain to the Premises. Subtenant hereby

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assumes and agrees to perform faithfully and be bound by, with respect to the Premises, all of Sublandlord's obligations, covenants, agreements and liabilities under the Master Lease Agreement except for the covenant of the Sublandlord to pay Master Landlord the Rent pursuant to Paragraph 1.6 of the Master Lease Agreement, and except as such terms, covenants, conditions and agreements are modified hereby, are not incorporated herein, or are inconsistent with the terms of this Sublease.

Without limitation of the foregoing:

- (i) Subtenant shall not make any changes, alterations or additions in or to the Premises except _____ as otherwise expressly provided herein;
- (ii) If Subtenant desires to take any other action and the Master Lease Agreement would require that Sublandlord obtain the consent of Landlord before undertaking any action of the same kind, Subtenant shall not undertake the same without the prior written consent of Sublandlord. Sublandlord may condition its consent on the consent of Master Landlord being obtained;
- (iii) All rights given to Master Landlord and its agents and representatives by the Master Lease Agreement to enter the premises covered by the Master Lease Agreement shall inure to the benefit of Sublandlord and their respective agents and representatives with respect to the Premises; provided that such right of entry shall also be subject to all applicable restrictions found in the Master Lease Agreement, as incorporated herein;
- (iv) Sublandlord shall also have all other rights, and all privileges, options, reservations and remedies, granted or allowed to, or held by, Master Landlord under the Master Lease Agreement, except as provided herein;
- (v) Subtenant shall maintain insurance of the kinds and in the amounts required to be maintained by Sublandlord under the Master Lease Agreement. All policies of liability insurance shall name as additional insureds the Master Landlord and Sublandlord and their respective officers, directors or partners, as the case may be, and the respective agents and employees of each of them; and
- (vi) Neither Sublandlord nor Subtenant shall do anything or suffer or permit anything to be done which could result in a default under the Master Lease Agreement or permit the Master Lease Agreement to be cancelled or terminated. Furthermore, each party will comply with the terms therein and will avoid actions or inactions that would constitute a breach or default of Sublandlord's obligations in the Master Lease Agreement.

Except as set forth below, the terms and conditions of this Sublease shall include all of the terms of the Master Lease Agreement and such terms are incorporated into this Sublease as if fully set forth herein, except that: (a) each reference in such incorporated sections to "Lease" shall be deemed a reference to "Sublease"; (b) each reference to "Landlord" and "**Tenant**" shall be deemed a reference to "**Sublandlord**" and "**Subtenant**", respectively, except as otherwise expressly set forth herein; (c) the following provisions shall not be included: Sections 1.1-1.4,

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1.5.1, 1.6.2, 1.6.3, 3.2 (last sentence only), 3.2(i), 3.2(ii), 3.2.2, 3.2.3, 5.1 (but not including 5.1.1-5.1.3), 21.1 (first sentence only), 21.2 (first sentence only), 23.1, 24, 28.1(l), 28.23, 28.26, Exhibit B-1, Exhibit E, Exhibit F, the First Addendum to Lease, and the Second Addendum to Lease; (d) references in the following provisions to "Landlord" shall mean "Master Landlord": Sections 1.7, 4.2(f)-(h), 4.2.1, 4.6-4.9, 8.2, 8.6.4, 9.9, 15.1-15.4, 16.1-16.4, 18.1, 18.2, 22, 25, and Exhibit D; and (e) wherever there is a requirement to pay the costs and expenses of "Landlord," Subtenant shall only be obligated to pay Master Landlord's costs and expenses and not both Sublandlord's and Master Landlord's costs and expenses. In the event of a conflict between the provisions of this Sublease and the Master Lease Agreement, as between Sublandlord and Subtenant, the provisions of this Sublease shall control.

To the extent that the Master Lease Agreement gives Sublandlord any right to terminate the Master Lease Agreement, Sublandlord shall not cancel or terminate the Master Lease Agreement, nor shall Sublandlord or Master Landlord amend or modify the Master Lease Agreement in any way which materially affects Subtenant's rights, without the prior written consent of Subtenant, which may be withheld in Subtenant's sole discretion.

If Master Landlord seeks to terminate the Master Lease Agreement because of default or alleged default by Sublandlord under the Master Lease Agreement, Sublandlord shall use its reasonable good faith efforts to maintain the Master Lease Agreement in full force and effect for the benefit of Subtenant and Sublandlord, and Sublandlord shall take all action required to reinstate the Master Lease Agreement and/or to claim and pursue any right of redemption or relief from forfeiture of the Master Lease Agreement (and as a consequence thereof any forfeiture of this Sublease) to which Sublandlord may be entitled at law or in equity (including, without limitation, any such rights under California Code of Civil Procedure Sections 1174 and 1179).

19. BOARD OF DIRECTORS' CONTINGENCY: : The final business terms and conditions between Subtenant and Sublandlord are subject to the approval of the Subtenant's and Sublandlord's respective Boards of Directors.

20. MASTER LANDLORD CONSENT: This Sublease shall be of no force or effect unless and until Sublandlord shall have obtained Master Landlord's written consent to this Sublease. Sublandlord shall not be obligated to take any action to obtain such consent other than to request such consent from Master Landlord in writing in the form attached hereto as Exhibit D (it being acknowledged that in no event shall Sublandlord be obligated to commence an action or proceeding to secure such consent). Sublandlord and Subtenant agree to (a) reasonably cooperate with the other party and Master Landlord in connection with the obtaining of such consent (including, without limitation, the furnishing of any information reasonably requested by Sublandlord or Master Landlord), and (b) execute any additional documents as reasonably requested by Master Landlord. Sublandlord shall pay any charges imposed by Master Landlord in connection with the furnishing of its consent hereto. If the Sublandlord has not obtained the written consent of Master Landlord in the form of Exhibit D, or some other mutually acceptable form, on or before the date of the Early Occupancy, then in addition to Subtenant's other rights or remedies, Subtenant may terminate this Sublease by written notice to Sublandlord, whereupon any monies previously paid by Subtenant to Sublandlord shall be reimbursed to Subtenant, or, at Subtenant's election, the date Subtenant is otherwise obliged to commence payment of rent shall

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be delayed by one (1) day after the Commencement Date for each day that the Master Landlord's consent is not obtained past the date of the Early Occupancy.

21. PARKING; ACCESS; SIGNAGE: Subtenant shall have access to unreserved parking spaces equal to the prorata share of the Premises to Master Premises. The parking ratio provided for in the Master Lease Agreement is approximately 3.4/1,000. Subtenant shall have access to the Premises 24 hours a day/7 days a week. Subtenant shall have the right to utilize the existing controlled access system (card key) to secure the Premises. Subtenant shall be responsible for building standard lobby and suite entry signage.

22. SUBLEASE ASSIGNMENT: Subtenant shall be permitted to assign or sublease any portion of the Premises, subject to Master Landlord and Sublandlord's approval, not to be unreasonably withheld. Subtenant and Sublandlord will share 50%/50% in all profits associated with either a sublease or an assignment to an unrelated entity, with said profits to be net of Subtenant's reasonable marketing expenses including but not limited to attorney fees, leasing commissions, allowances, incentives and rent credits.

23. WAIVER OF CLAIMS AND INDEMNITY:

(a) Subtenant hereby releases and waives any and all claims against Master Landlord and Sublandlord and each of their respective officers, directors, partners, agents and employees for injury or damage to person, property or business sustained in or about the Building, the Premises subject to the Master Lease Agreement, or the Premises by Subtenant other than by reason of negligence or willful misconduct on the part of Master Landlord or Sublandlord and except in any case which would render this release and waiver void under law.

(b) Subtenant agrees to indemnify, defend and hold harmless Master Landlord and its beneficiaries, Sublandlord and the managing agent of the Building and each of their respective officers, directors, partners, agents and employees, from and against any and all claims, demands, costs and expenses of every kind and nature, including attorneys' fees and litigation expenses, arising from Subtenant's occupancy of the Premises, Subtenant's construction of any leasehold improvements in the Premises or from any breach or default on the part of Subtenant in the performance of any agreement or covenant of Subtenant to be performed or performed under this Sublease or pursuant to the terms of this Sublease, or from any act or neglect of Subtenant or its agents, officers, employees, guests, servants, invitees or customers in or about the Premises. In case any such proceeding is brought against any of said indemnified parties, Subtenant covenants, if requested by Sublandlord, to defend such proceeding at its sole cost and expense by legal counsel reasonably satisfactory to Sublandlord.

(c) Sublandlord agrees to indemnify, defend and hold harmless Subtenant and its beneficiaries, and each of their respective officers, directors, partners, agents and employees, from and against any and all claims, demands, costs and expenses of every kind and nature, including attorneys' fees and litigation expenses, arising from Sublandlord's prior occupancy of the Premises or from any breach or default on the part of Sublandlord in the performance of any agreement or covenant of Sublandlord to be performed or performed under this Sublease or pursuant to the terms of this Sublease, or from any act or neglect of Sublandlord or its agents,

officers, employees, guests, servants, invitees or customers in or about the Premises. In case any such proceeding is brought against any of said indemnified parties, Sublandlord covenants, if requested by Subtenant, to defend such proceeding at its sole cost and expense by legal counsel reasonably satisfactory to Subtenant.

24. WAIVER OF SUBROGATION:

Notwithstanding anything in this Sublease to the contrary, Sublandlord and Subtenant hereby release each other and their respective agents, employees, successors, assignees and sublessees from all liability for injury to any person or damage to any property that is caused by or results from a risk which is actually insured against, which is required to be insured against under the Master Lease or this Sublease, or which would normally be covered by "all risk" property insurance, without regard to the negligence or willful misconduct of the person or entity so released. All of Sublandlord's and Subtenant's repair and indemnity obligations under this Sublease shall be subject to the waiver and release contained in this paragraph. Each Party shall cause each insurance policy it obtains to provide that the insurer thereunder waives all recovery by way of subrogation as required herein in connection with any injury or damage covered by such policy.

25. DEFAULT BY SUBTENANT:

(a) Upon the happening of any of the following:

(i) Subtenant fails to pay Rent within ten (10) days after the due date;

(ii) Subtenant fails to pay any other amount due by the applicable due date from Subtenant hereunder and such failure continues for five (5) days after notice thereof from Sublandlord to Subtenant;

(iii) Subtenant fails to perform or observe any other covenant or agreement set forth in this Sublease and such failure continues for seven (7) days after notice thereof from Sublandlord to Subtenant; or if such failure to perform or observe is not curable within seven (7) days, if Subtenant fails to commence such cure within such seven (7) day period and diligently pursue such cure to completion.

(iv) any other event occurs which involves Subtenant or the Premises and which would constitute a default under the Master Lease if it involved Sublandlord or the premises covered by the Master Lease;

If after receiving a notice of a defect Subtenant has failed to timely cure such defect, Subtenant shall be deemed to be in default hereunder, and Sublandlord may exercise, without limitation of any other rights and remedies available to it hereunder or at law or in equity, any and all rights and remedies of Landlord set forth in the Master Lease, as incorporated herein.

(b) In the event Subtenant fails or refuses to make any payment or perform any covenant or agreement to be performed hereunder by Subtenant, Sublandlord may make such payment or

undertake to perform such covenant or agreement (but shall not have any obligation to Subtenant to do so). In such event, amounts so paid and amounts expended in undertaking such performance, together with all costs, expenses and attorneys' fees incurred by Sublandlord in connection therewith, shall be additional rent hereunder.

26. BROKERAGE FEE: _____ represents the Subtenant and _____ represents the Sublandlord in this transaction. Upon completion of a transaction between both parties, Sublandlord shall pay _____ a full-market leasing commission based on a separate written agreement. Except as set forth herein, each party hereby represents and warrants to the other that it has had no dealings with any real estate broker or agent in connection with this Sublease, and that it knows of no other real estate broker or agent who is or might be entitled to a commission in connection with this Sublease. Each party agrees to protect, defend, indemnify and hold the other harmless from and against any and all claims inconsistent with the foregoing representations and warranties for any brokerage, finder's or similar fee or commission in connection with this Sublease, if such claims are based on or relate to any act of the indemnifying party which is contrary to the foregoing representations and warranties.

27. SEVERABILITY: If any part or parts of this Sublease shall be held unenforceable for any reason, the remainder of this Sublease shall continue in full force and effect. If any provision of this Sublease is deemed invalid or unenforceable by any court of competent jurisdiction, and if limiting such provision would make the provision valid, then such provision shall be deemed to be construed as so limited.

28. BINDING EFFECT: The covenants and conditions contained in the Sublease shall apply to and bind the Parties and the heirs, legal representatives, successors and permitted assigns of the Parties.

29. ENTIRE AGREEMENT: This Sublease, including the Exhibits, constitutes the entire agreement between the Parties and supersedes any prior understanding or representation of any kind preceding the date of this Sublease. There are no other promises, conditions, understandings or other agreements, whether oral or written, relating to the subject matter of this Sublease. This Sublease may be modified in writing and must be signed by both Parties.

30. GOVERNING LAW: This Sublease shall be governed by and construed in accordance with the laws of the State of California.

31. NOTICE: Any notice required or otherwise given pursuant to this Sublease shall be in writing and mailed certified return receipt requested, postage prepaid, or delivered by overnight delivery service, if to Subtenant, at 341 Oyster Point Boulevard, South San Francisco, CA 94080, Attention: Legal Department, and if to Sublandlord, to _____. Either party may change such addresses from time to time by providing notice as set forth above.

32. WAIVER; AMENDMENT: The failure of either Party to enforce any provisions of this Sublease shall not be deemed a waiver or limitation of that Party's right to subsequently enforce and compel strict compliance with every provision of this Sublease. The acceptance of rent by _____

Sublandlord or Master Landlord does not waive Sublandlord's right to enforce any provisions of this Sublease.

This Sublease may not be amended or terminated, in whole or in part, nor may any of the provisions be waived, except by a written instrument executed by the Party against whom enforcement of such amendment, termination or waiver is sought and unless the same is permitted under the terms and provisions of the Master Lease Agreement.

33. LEGAL FEES: In the event of any legal action by the Parties arising out of this Sublease, the losing Party shall pay the prevailing Party reasonable attorneys' fees and costs in addition to all other relief.

34. AUTHORITY: Sublandlord and Subtenant each hereby represents and warrants that it has full right, power and authority to enter into this Sublease and that the person executing this Sublease on behalf of Sublandlord and Subtenant, respectively, is duly authorized to do so.

IN WITNESS WHEREOF, the Parties have caused this Sublease to be executed the day and year first above written.

SUBLANDLORD:

SUBTENANT:

SUNESIS PHARMACEUTICALS, INC.

(Name)

(Name)

(Position)

(Position)

EXHIBIT A
FLOOR PLANS

O Y S T E R P O I N T M A R I N A P L A Z A

Office Lease

of

SUITES & 400

to

a Delaware limited partnership

395 Oyster Point Boulevard
South San Francisco, CA 94080

O Y S T E R P O I N T M A R I N A P L A Z A

Office Lease

THIS OFFICE LEASE (the "Lease") is entered into as of June 1, 2003, by and between _____, a California corporation ("Landlord") and _____, a Delaware limited partnership ("Tenant").

1 BASIC LEASE TERMS

1.1 LEASE OF PREMISES. Landlord leases to Tenant, and Tenant rents and hires from Landlord, the premises described in § 1.4 below, in the building known by the street address 395 Oyster Point Boulevard (the "Building") in the City of South San Francisco, County of San Mateo, State of California, on the property described in § 1.7 below, in the business park commonly known as Oyster Point Marina Plaza (the "Complex"), for the term stated in § 1.5 below, for the rents hereinafter reserved, and upon and subject to the terms, conditions (including limitations, restrictions, and reservations), and covenants hereinafter provided. The Building and the Complex are more particularly described and depicted in Exhibit A which is attached hereto. Each party hereby expressly covenants and agrees to observe and perform all of the conditions and covenants herein contained on its part to be observed and performed.

1.2 Existing Tenancy Acknowledged and Amended. Landlord and Tenant acknowledge that Tenant currently occupies approximately _____ rentable square feet of space on the fourth (4th) floor of the Building and approximately _____ rentable square feet of space on the _____ floor of the Building (collectively the "Existing Premises") under the terms of that certain lease dated as of May 2, 1996, between Landlord and Tenant (the "Existing Lease") as the same has been heretofore modified and amended. In the absence of the parties' execution and delivery of this Lease, the Existing Lease would have expired on its terms on March 31, 2005. Notwithstanding anything to the contrary in the Existing Lease, Landlord and Tenant agree that the terms, conditions, and covenants of this Lease shall supersede those of the Existing Lease for all purposes from and after the Commencement Date hereof, that the Existing Lease shall terminate for all purposes on the Commencement Date of this Lease with the same effect as if the Term of the Existing Lease had expired on the Commencement Date hereof, and that Tenant's occupancy of the Premises shall be governed solely by the terms, covenants, and conditions of this Lease from and after the Commencement Date. The Existing Lease is hereby amended to reflect the provisions of this § 1.2 *et seq.*

1.2.1 Translation of Premises. Subject to the terms and conditions of the Work Letter Agreement attached hereto as Exhibit F, Tenant shall have the right during the performance of Landlord's Work in Suite 500 to install Tenant's telephone and data lines in Suite 500 as soon as the walls are roughed out in anticipation of Tenant's move into Suite 500 on or after the Commencement Date. Tenant agrees to vacate the Existing Premises and to complete its move into Suite 500 on or before the date which is one (1) month (including four (4) weekends) after the Commencement Date (as defined in § 1.5 below) of this Lease (the "Existing Premises Termination Date").

1.2.2 Existing Lease Base Rent Abatement. Notwithstanding anything to the contrary in the Existing Lease, commencing with retroactive effect on **April 1, 2003**, and continuing through and including the Commencement Date of this Lease (the "Existing Lease Abatement Period"), **Tenant's** Monthly Installment of Base Rent with respect to the Existing Premises under the Existing Lease shall be reduced from its current level to **Eight-Four Thousand Four Hundred Thirty-Five Dollars and Seventy-Five Cents (\$84,435.75)** per month, prorated as appropriate; provided that, if Tenant shall not have executed and delivered this Lease to Landlord on or before the close of business on August 9, 2003, the commencement of the Existing Lease Abatement Period shall be delayed by one (1) day for each day of the interval between August 9, 2003, and the date upon which Tenant shall actually execute and deliver this Lease to Landlord. For example, if Tenant executes and delivers this Lease to Landlord on August 19, 2003, the Base Rent for the period August 9, 2003, through August 19, 2003, will be \$52,883.30 (\$158,650/30 days x 10 days) rather than \$28,145.25 (\$84,435.75/30 days x 10 days). If Tenant shall materially default under the Existing Lease at any time prior to its termination as provided in § 1.2 above and fail to cure within the time permitted for cure thereunder, while the Existing Lease Abatement Period is still in effect, the Existing Lease Abatement Period shall thereupon terminate, all amounts theretofore abated shall become immediately due and payable to Landlord, and Tenant shall commence paying the Base Rent under the Existing Lease as specified thereunder. In addition, if Tenant shall default under this Lease at any time and fail to cure within the time permitted for cure hereunder, Tenant shall upon demand pay Landlord the amount of Existing Lease Base Rent theretofore abated under the Existing Lease as amended pursuant to the terms of this § 1.2.2 during the Existing Lease Abatement Period, multiplied by a fraction, the numerator of which is the number of months then remaining in the initial Term of this Lease at the time of the default, and the denominator of which is the total number of months in the initial Term of this Lease (without limiting Landlord's other remedies).

1.3 SUMMARY TABLE. The parties agree that the following table (the "Table") sets forth in summary form the basic terms of this Lease, including the specific space comprising the Premises and, with respect to such space, the Term of the Lease, the usable and rentable square footage, the Base Rent, Base Year, and Tenant's Share, as all of such terms are defined below:

PERIOD	SUITE NO.	RSF	MONTHLY BASE RENT	T'S SHARE BLDG	T'S SHARE COMPLEX	BASE YEAR
Commencement Date to January 31, 2005						
Suite 400 Commencement Date to January 31, 2005	400	8,448	\$ 14,784.00	3.630%	1.819%	2004
February 1, 2005 to January 31, 2006	400	8,448	\$ 15,206.40	3.630%	1.819%	2004
February 1, 2006 to January 31, 2007	400	8,448	\$ 15,628.80	3.630%	1.819%	2004
February 1, 2007 to January 31, 2008	400	8,448	\$ 16,051.20	3.630%	1.819%	2004
February 1, 2008 to January 31, 2009	400	8,448	\$ 16,473.60	3.630%	1.819%	2004
February 1, 2009 to January 31, 2010	400	8,448	\$ 16,896.00	3.630%	1.819%	2004
February 1, 2010 to January 31, 2011	400	8,448	\$ 17,318.40	3.630%	1.819%	2004
February 1, 2011 to January 31, 2012	400	8,448	\$ 17,740.80	3.630%	1.819%	2004
February 1, 2012 to January 31, 2013	400	8,448	\$ 18,163.20	3.630%	1.819%	2004
February 1, 2013 to January 31, 2014	400	8,448	\$ 18,585.60	3.630%	1.819%	2004
TOTALS:						

In the event of any conflict between the terms contained in the Table and the terms contained in subsequent sections of the Lease, the terms of the Table shall control, except that any dates stated in the Table are subject to adjustment as appropriate to the extent any other provisions of the Lease provide for adjustments to the Commencement Date and/or the Expiration Date and subject to the rental abatement provided in § 1.6.3 below.

1.4 PREMISES. The premises leased to Tenant (the "Premises") are (i) the entire floor and (ii) a portion of the fourth (4th) floor of the Building and are commonly known as **Suites** and **400**, as shown on the floor plans annexed hereto as **Exhibit B**. The Premises also include all fixtures and equipment which are attached thereto, except items not deemed to be included therein and which are removable by Tenant as provided in Article 10 below. Landlord and Tenant agree that the usable and rentable area of the Premises, and the respective rentable areas of the Property (as defined in § 1.7 below) and Complex, for all purposes under this Lease, are as follows and as specified in the Table:

Property's Rentable Area:
Complex's Rentable Area:

Tenant acknowledges that it has caused its architect to verify the numbers stated in the Table and herein relating to the measurements of such spaces prior to the Commencement Date of this Lease or has had an opportunity to do so.

1.4.1 Expansion Rights. In consideration for Tenant's execution and delivery of this Lease, provided no material Event of Default remains outstanding and uncured beyond all applicable notice and cure periods on the date Tenant exercises its rights under this § 1.4.1 *et seq.*, Landlord hereby grants to Tenant the following rights of first refusal with respect to the following spaces (collectively the "RFR Space"):

(i) a first right of refusal for any space on Floors 4 and in the Building for a period of five years from August 1, 2005, through July 31, 2010 (the "4th- RFR Space"), subject to (a) the right of any existing tenant to exercise any option in effect prior to the Commencement Date and (b) the right of Landlord to negotiate a lease renewal with any existing tenant. Tenant acknowledges that Coremark International currently leases approximately rentable square feet of space on the fourth floor under a lease expiring on June 30, 2007, and containing a five-year renewal option; and

(ii) a first right of refusal for the following spaces (the "Specific RFR Spaces") in the Building for a period of four years from August 1, 2005, through July 31, 2009:

- Suite currently occupied by under a lease expiring on October 31, 2003;
- Suite currently occupied by Tenant;
- Suite currently occupied by the with a lease expiration date of April 30, 2007, with a five-year lease extension option;
- Suite currently occupied by the with a lease expiration date of April 30, 2007, with a five-year lease extension option;
- Suite currently vacant but adjacent to Suite 225.

(a) **Notice of Bona Fide Offer.** Landlord shall notify Tenant regarding the availability of the RFR Space prior to putting the RFR Space on the market for lease. In addition, if at any time during the periods specified in § 1.4.1 above Landlord receives a *bona fide* offer, agreement, or proposal ("Lease Proposal") which is acceptable to Landlord from any third party to lease any portion of the RFR Space; or if Landlord makes a *bona fide* offer, agreement, or proposal to a third party which the third party is willing to accept, Landlord shall send Tenant a summary (the "RFR Summary") of the economic terms and conditions of the Lease Proposal, including a description of the subject space, proposed term, and basic business terms and shall notify Tenant of Landlord's intention to conclude a lease on the terms of the Lease Proposal. Tenant shall have the right for a period of five (5) full working days (concluding on 5:00 p.m.) following Tenant's receipt of the RFR Summary in which to exercise its right to lease the space described in the RFR Summary (the "RFR Space") on the terms and conditions set forth in this § 1.4.1 *et seq.* by giving Landlord written notice of such exercise. If Tenant fails to notify Landlord of the exercise of its rights hereunder within such five-business-day period, Landlord may then lease the RFR Space to the third party tenant named as the tenant in the RFR Summary or an affiliate of such third party tenant, provided that the lease entered into pursuant to the Lease Proposal is (i) on the same terms and conditions as set forth in the RFR Summary or (ii) on substantially the same terms and conditions as set forth in the RFR Summary and Landlord is not required to re-offer such First Refusal Space to Tenant pursuant to § 1.4.1(d) below.

(b) **Commencement and Duration.** If Tenant exercises its right of first refusal, Landlord shall make the RFR Space available for purposes of construction of improvements within ninety (90) days following Tenant's exercise of this right of first refusal (the "RFR Space Delivery Date"); the lease for the RFR Space shall commence as provided herein and shall continue for the duration of the Term of the Lease and expire coterminously therewith. The RFR Space shall be provided "as is" for purposes of construction, with all existing tenant improvements in place. The parties agree that Landlord shall improve the RFR Space within ninety (90) days of the RFR Space Delivery Date, whether or not the RFR Space has been previously improved, in accordance with the terms of the Work Letter Agreement, with appropriate changes being made only to the Plans and Specifications, Construction Schedule and the amount of the Improvement Allowance, which amount shall be determined as provided below. Tenant shall deliver to Landlord for approval (which shall not to be unreasonably withheld, conditioned, or delayed) Tenant's proposed plans and specifications no later than ninety (90) days following Tenant's exercise of this right of first refusal. Landlord shall, following selection of a contractor mutually agreed upon by Landlord and Tenant ("Contractor") and approval of construction costs by Tenant, construct within the RFR Space the improvements specified in the final approved plans and specifications for such construction. The commencement date of the lease of such RFR Space (upon which Base Rent and Additional Rent shall begin to accrue, and Tenant's Pro Rata Share shall be adjusted to take into account the RFR Space) shall be the earlier of (i) the date upon which Landlord's construction of the improvements within the RFR Space satisfies the Delivery Requirements (hereinafter defined) with respect to the RFR Space or (ii) the date upon which Tenant occupies the RFR Space (or any portion thereof) and commences conducting Tenant's business operations therein; provided, however, that in the event of any Tenant Delay (hereinafter defined), Tenant's obligation to pay Base Rent and Additional Rent with regard to such RFR Space shall be advanced by one (1) day for each such day substantial completion of such improvements was delayed by a Tenant Delay. Following Landlord's delivery of the RFR Space in compliance with all Delivery Requirements, the RFR Space shall be deemed to be a part of the Premises and shall be leased by Tenant upon and subject to all of the terms, covenants, and conditions of this Lease.

(c) **Terms and Conditions.** If Tenant exercises its right of first refusal as to the RFR Space, all terms and conditions for the lease of any such space shall be the same as those then in effect under the Lease, except for the rental, tenant inducements, rent abatements, and improvement allowances ("Third-Party Economics"). Tenant shall have the right to a lease of the RFR Space upon such Third-Party Economics as were contained

in the Lease Proposal in the same proportion as the number of months remaining in the Term (including the term of any extension option then having been exercised) bears to the number of months in the lease term contained in the RFR Summary.

(d) Continuing Right, Re-Offer, and Priority. If Tenant shall not timely exercise the right of first refusal contained herein upon notification by Landlord, Tenant shall again have the same rights as to such space each time Landlord receives or makes a *bona fide* offer, from or to a third party, which both Landlord and the third party are willing to accept, to lease such space, whether or not Tenant has previously exercised or refused to exercise the rights herein contained with respect to such space or other space. If Tenant rejects or is deemed to have rejected a *bona fide* offer of which Tenant is notified, and if (i) such third-party *bona fide* offer is not consummated within five (5) months; (ii) the effective rental rate to be paid pursuant to the *bona fide* offer changes in any respect so as to become more than five percent (5%) more favorable to the prospective tenant; (iii) there is any change in the term, expansion rights, extension rights, or renewal rights proposed in the Lease Proposal; or (iv) there is any other material change in the nonmonetary terms of the *bona fide* offer, then the RFR Space shall again become subject to the terms of this § 1.4.1 *et seq.* and shall again be offered to Tenant as provided above. As used in the previous sentence, the term *effective rental rate*

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means an amount determined by taking the total base rental and deducting all abatements, allowances, cost of non-monetary tenant inducements (e.g., health club memberships, etc.), tenant improvement costs in excess of Building-standard, and any other monetary inducements. Landlord represents and warrants that the rights of first refusal granted to Tenant herein are and shall be paramount in interest to the rights of Landlord to use the First Refusal Space for its own purposes and that no other tenant of the Building has a right of first refusal or other expansion right prior to or superior to the rights granted to Tenant herein. The foregoing right of first refusal shall be subject to the existing tenants' or occupants' of the First Refusal Space renewing their existing leases pursuant to options to extend or renew which are in existence in their written lease agreements as of the date of this Lease.

(e) Confirmatory Documentation. After Tenant validly exercises the right of first refusal provided herein, the parties shall execute an amendment to the Lease adding the First Refusal Space, or such other documentation as Landlord shall reasonably require, promptly after Landlord shall prepare the same, in order to confirm the leasing of such First Refusal Space to Tenant; but an otherwise valid exercise of the rights of first refusal contained herein shall be fully effective, whether or not such confirmatory documentation is executed.

(f) Failure to Exercise. If Tenant shall fail to exercise its right of first refusal after notice by Landlord of the receipt of a *bona fide* third-party offer to lease the RFR Space within the time specified herein, such right shall be deemed to have lapsed and expired with respect to that particular RFR Summary, and Landlord may, for a period of five (5) months, enter into a lease pursuant to the terms of the RFR Summary with the prospective tenant named therein.

(g) Default and Termination. Tenant's exercise of such right of first refusal hereunder shall not operate to cure any default by Tenant of any of the terms or provisions in the Lease, nor to extinguish or impair any rights or remedies of Landlord arising by virtue of such default. The exercises of the right of first refusal herein shall, at Landlord's election, be null and void if Tenant has committed a material Event of Default which remains outstanding and uncured beyond all applicable notice and cure periods on the date Tenant exercises its rights hereunder. Tenant agrees that time is of the essence of rights of first refusal specified herein.

(h) Effect of Transfer. If Tenant subleases or assigns any portion of the Premises at any time during the Term of this Lease except for a Transfer pursuant to § 17.12 below, the rights of first refusal hereunder with respect to the Specific RFR Spaces shall be suspended with immediate effect until such time as Tenant reoccupied the entirety of the Premises.

1.4.2 Generator License. Landlord hereby grants to Tenant, for the Term of the Lease and any extension thereof, the right to maintain, and operate an above-ground, emergency, diesel-powered electrical generator (the "Generator") and an associated above ground diesel storage tank (the "Tank") on the terms and conditions specified herein. Landlord and Tenant acknowledge that the Generator was installed by Tenant prior to the Commencement Date of this Lease pursuant to the terms of the Fourth Amendment, dated as of July 5, 2001, to the Existing Lease.

(a) Scope of Right. Tenant's right hereunder to maintain and operate the Generator and Tank is granted solely for the purpose of providing emergency electrical supply to the Premises, limited to the duration of any failure in the electrical power supplied to the Building and for routine testing, and for no other purpose. Tenant shall not permit the Generator and Tank to be utilized, directly or indirectly, by any person or entity other than Tenant and its agents.

(b) Term of License. The term of the right granted hereunder to maintain and operate the Generator shall be coextensive with the Term of the Lease. Tenant may terminate the right

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conferred hereunder at any time upon not less than thirty (30) days' written notice to Landlord, provided that upon any such termination Tenant shall have no further right thereafter to operate the Generator or utilize the Generator Area, and Tenant shall upon such termination comply with the provisions of § 1.4.2(h) below.

(c) Location of Generator and Tank. The Generator and Tank shall occupy an area measuring approximately twelve (12) feet by seventeen (17) feet (the "Generator Area") in the parking area of the Building where the Generator Area was located on the Commencement Date of this Lease. The Generator Area shall be deemed a part of the Premises so long as the right to operate the Generator granted herein remains in effect, and its use and operation shall be subject to all the terms and conditions applicable to Tenant's use of the Premises under the Lease, except to extent specified to the contrary herein.

(d) Enclosure and Concealment. The Generator Area shall be entirely surrounded by a wall, tall enough to conceal the Generator and Tank from view, constructed of either cinder block or poured-in-place concrete, similar in appearance to the exterior of the Building. In addition, so long as the operation of the Generator is not adversely affected thereby, Tenant shall place a raised wooden trellis, in appearance reasonably satisfactory to Landlord, over the Generator Area so as to conceal the Generator and Tank from the view of occupants of the Building looking down on the Generator Area from above.

(e) Landscaping. Tenant agrees to install (a) a planter on the south side of the Generator Area which is designed to match the existing planter on the north side of the Generator Area and (b) a planter or planter strip approximately eighteen inches (18") wide across the front of the Generator area. All planters will be planted with agapanthus as a foundation planting and a climbing vine of a variety appropriate for this application, as reasonably directed by Landlord, for the enclosure itself.

(f) Cost of Operation. Tenant shall bear all costs associated with the construction, installation, maintenance, repair, and operation of the Generator and Tank and associated systems, and Landlord shall have no obligation under any circumstances to pay any costs in connection with such activities.

(g) Electrical Connection and Consumption. Except as may be necessary to repair or replace the electrical conduit running between the Generator and the Premises, no trenching or boring of the parking area of any other area of the Property shall be permitted. Tenant shall bear all costs, as reasonably estimated by Landlord, for electricity consumed in the lighting and maintenance of the Generator and Generator Area; provided that Tenant shall have the right to install an electrical submeter at its own expense at the Generator, in which case Tenant's obligation to reimburse Landlord for the cost of electricity consumed at the Generator Area shall be based upon Tenant's actual consumption as shown on such submeter. Notwithstanding any other provision of the Lease to the contrary, except to the extent caused by Landlord's negligence or intentional acts, Tenant shall be fully liable for all costs incurred in connection with damage to the Building or the Building's electrical system by virtue of Tenant's operation of the Generator, and Tenant agrees to take all appropriate precautions, as directed by a licensed electrician approved by Landlord, to prevent any such damage. Tenant agrees to pay to Landlord promptly upon invoicing the costs of repairing any such damage.

(h) Removal and Restoration. If directed by Landlord by written notice given at least twelve (12) months prior to the Expiration Date as the same may be extended hereunder, Tenant shall remove the Generator, Tank, Generator Area, and all associated structures and systems upon

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the expiration or earlier termination of the Lease and shall restore the Generator Area to its prior condition before installation of the Generator under the Fourth Amendment to the Existing Lease; provided that Landlord may give contemporaneous notice in the event the Lease terminates prior to the Expiration Date as the same may be extended hereunder.

(i) Insurance and Indemnification. Tenant agrees to cover the location, maintenance, and operation of the Generator and Tank under Tenant's CGL insurance coverages under the Lease. Notwithstanding anything to the contrary in the Lease, Tenant shall indemnify, defend, protect, and hold Landlord harmless from and against (a) any and all Claims relating to injury or damage occurring in, on, or about any of the Common Areas, the Property, or the Complex, when such injury or damage is caused in whole or in part by Tenant's installation, maintenance, or operation of the Generator or Tank and (b) all costs, attorneys' fees, expenses, and liabilities incurred in connection with any such Claim or any action or proceeding brought thereon, except to the extent any claim is due to the negligence or intentional acts of Landlord. In case any action or proceeding be brought against Landlord by reason of any such Claim, Tenant, upon notice from Landlord, shall defend the same at Tenant's expense by counsel reasonably satisfactory to Landlord.

(j) Hazardous Waste. All the terms and provisions of the Lease regarding hazardous waste and hazardous materials shall apply to Tenant's use of the Generator and Generator Area hereunder.

(k) Condition of Generator Area and Surrounding Area. Tenant shall keep the Generator Area and any items as Tenant may have at the Generator Area in a neat and clean condition. No boxes, back-up stock, vent pipes or personal items shall be visible at any time. Tenant shall keep the area around the Generator Area free of any refuse or other items originating from the Generator Area or arising out of Tenant's activities thereat. Without limitation, Tenant shall not allow any substance on the floor area at or around the Generator Area which may cause the floor to be slippery or otherwise hazardous to persons walking on the floor. Tenant shall promptly repair any damage to the Generator Area or the surrounding area caused by Tenant or arising out of Tenant's activities.

(l) Work at Generator Area. Except for any work under subsection (e) above, any type of work Tenant shall wish to perform at the Generator Area, including any type of construction work or painting, shall be subject to Landlord's advance approval and shall be performed only at such times as agreed upon by Landlord. No such work shall be performed during business hours (as defined in § 8.1.1 below), unless otherwise approved by Landlord.

(m) Noises, Odors and Other Matters. Other than as may be due to normal operation and maintenance of the Generator, Tenant shall not permit any noises, music, odors, or other matters to occur at or about the Generator Area so as to unreasonably interfere with other Building occupants' use and enjoyment of their respective premises.

1.4.3 Roof and Antenna License. Tenant shall have the right during the Term of this Lease, subject to Landlord's reasonable approval, to place up to a maximum of three (3) antennae on the roof of the Building for Tenant's own communications purposes. Any such antennae shall not exceed eighteen inches (18") in height or diameter. Tenant agrees to execute a separate roof license agreement substantially on Landlord's Building-standard form in connection with any such utilization of the Building roof space for placement of communications antennae. In addition, Landlord hereby grants Tenant a license for roof access for the purpose of maintaining its roof antennae and for maintaining Tenant's Supplemental HVAC System, as required under § 8.1 below.

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1.5 TERM. The term (the "Term") for which the Premises are hereby leased shall commence on the "Commencement Date," which shall be the earlier to occur of (i) the day on which Suite is ready for occupancy (as defined in Article 3) or (ii) the day on which Tenant or anyone claiming under or through Tenant first occupies Suite for business, and shall end at noon on the "Expiration Date," which shall be the last day of the calendar month in which occurs the day preceding the tenth (10th) anniversary of the Commencement Date (notwithstanding anything to the contrary in the Table) or any earlier date upon which the Term may expire or be cancelled or terminated pursuant to any of the conditions or covenants of this Lease or pursuant to law. Promptly following the Commencement Date the parties hereto shall, if required by Landlord, enter into a supplementary agreement fixing the dates of the Commencement Date and the Expiration Date in the form which is attached hereto as **Exhibit E** and incorporated herein by reference. The Term with respect to Suite 400 only shall commence shall on the earlier to occur of (i) the day on which Suite 400 is ready for occupancy (as defined in Article 3) or (ii) the day on which Tenant or anyone claiming under or through Tenant first occupies Suite 400 for business (the "Suite 400 Commencement Date").

1.5.1 Extension Option. Tenant is hereby granted one (1) option to extend (the "Extension Option") the Term of the Lease for an additional period of five (5) consecutive Lease Years (the "Extension Period"). The Extension Period term shall begin the first day following the Expiration Date of the Lease and shall take effect on the same terms and conditions in effect under the Lease immediately prior to the Extension Period, except that (i) Tenant shall have no further right to extend and (ii) monthly Base Rent shall be the rate which is ninety-eight percent (98%) of Fair Market Value (as defined below). The Fair Market Value shall be the effective rent (face rate less free rent) being charged for comparable space in comparable buildings in the vicinity of the Complex leased on comparable terms, including annual escalations and such other terms.

(a) Exercise of Option. The Extension Option may be exercised only by (i) delivering written notice of Tenant's irrevocable election to exercise to Landlord in accordance with Article 23 below no earlier than **January 1, 2013**, and no later than **April 1, 2013**. Tenant's exercise of its Extension Option shall not be effective or valid if there is any deviation in the timing or manner of exercise prescribed herein.

(b) Failure to Exercise. If Tenant shall fail validly and timely to exercise the option herein granted, the Extension Option shall terminate and shall be null and void and of no further force and effect.

(c) Fair Market Value. Provided that Tenant has validly exercised its option when and as required hereunder, Landlord shall, on or before **May 1, 2013**, provide written notice to Tenant of its determination of the Fair Market Value. Within ten (10) days after receiving such determination (and in no event later than **June 1, 2013**) ("Tenant's Review Period"), Tenant shall irrevocably elect, in writing, to do one of the following: (i) accept Landlord's determination; or (ii) object to Landlord's determination and with such objection set forth in writing Tenant's determination of the Fair Market Value. If Tenant so objects, Landlord and Tenant shall attempt in good faith to agree upon such Fair Market Value using their best good-faith efforts. If Landlord and Tenant fail to reach agreement within fifteen (15) days following Tenant's Review Period (the "Outside Agreement Date"), then Landlord and Tenant shall submit each party's determination to arbitration in accordance with the then-current rules and procedures of the American Arbitration Association. If Tenant objects to Landlord's determination of Fair Market Value, Tenant shall continue to pay Base Rent as set forth in § 1.3 until the matter is resolved by binding arbitration as provided below, subject to retroactive adjustment after the matter is so resolved. If Tenant fails so to accept or object to Landlord's

determination of Fair Market Value in writing within Tenant's Review Period, Tenant shall conclusively be deemed to have approved of the Fair Market Value as determined by Landlord.

(d) Appointment of Arbitrators. Not later than fifteen (15) days following the Outside Agreement Date, Landlord and Tenant shall each appoint one arbitrator who shall by profession be a real estate broker who shall have been active over at least the ten-year period ending on the date of such appointment in the leasing of commercial properties within northern San Mateo County. The determination of the arbitrators shall be limited solely to the issue of whether Landlord's or Tenant's submitted Fair Market Value for the Premises is the more accurate as determined by the arbitrators, taking into account the requirements of this § 1.5.1 *et seq.*

(e) Appointment of Third Arbitrator. The two (2) arbitrators so appointed shall within fifteen (15) days of the date of the appointment of the last-appointed arbitrator agree upon and appoint a third arbitrator, who shall be qualified under the same criteria as set forth hereinabove for qualification of the initial two arbitrators.

(f) Arbitrators' Decision. The three (3) arbitrators shall, within thirty (30) days of the appointment of the third arbitrator, reach a decision as to whether the parties shall use Landlord's or Tenant's submitted Fair Market Value, and shall notify Landlord and Tenant thereof. The decision of the majority of the three (3) arbitrators shall be binding upon Landlord and Tenant. The arbitrators shall not be permitted to set Fair Market Value to any level other than either Landlord's or Tenant's submitted Fair Market Value.

(g) Failure to Appoint. If either Landlord or Tenant fails to appoint an arbitrator within fifteen (15) days after the Outside Agreement Date, the arbitrator timely appointed by one of the parties shall reach a decision, notify Landlord and Tenant thereof, and such arbitrator's decision shall be binding upon Landlord and Tenant. If the two (2) arbitrators fail to agree upon and appoint a third arbitrator, both arbitrators shall be dismissed and the matter to be decided shall be forthwith submitted to arbitration under the Commercial Arbitration Rules of the American Arbitration Association then in effect, but subject to the instructions set forth in this § 1.5.1 *et seq.*

(h) Cost of Arbitration. The cost of arbitration shall be paid by Landlord and Tenant equally.

(i) Default. Tenant's exercise of the Extension Option shall, at Landlord's election, be null and void if Tenant is in material default of its obligations under this Lease beyond all applicable notice and cure periods on the date of exercise or at any time thereafter and prior to commencement of the Extension Period. Tenant's exercise of the Extension Option shall not operate to cure any Default by Tenant nor to extinguish or impair any rights or remedies of Landlord arising by virtue of such Default. If the Lease or Tenant's right to possession of the Premises shall terminate before Tenant shall have exercised the Extension Option, then immediately upon such termination the Extension Option shall simultaneously terminate and become null and void.

(j) Time. Time is of the essence of this Extension Option.

1.5.2 Suite 400 Termination Right. Notwithstanding anything to the contrary herein, Tenant shall have the right to terminate the Lease with respect to Suite 400 only effective on either **September 30, 2008**, or **September 30, 2010**, upon written notice given to Landlord not less than six (6) months and not more than nine (9) months prior to either such termination date that may be selected by Tenant. If Tenant exercises such termination right, Tenant shall pay to Landlord a termination fee on the

termination date of either **Ninety-Six Thousand Three Hundred Seven Dollars and Twenty Cents (\$96,307.20)**, if Tenant exercises its right to terminate the Lease with respect to Suite 400 on September 30, 2008, or **Sixty-Nine Thousand Two Hundred Seventy-Three Dollars and Sixty Cents (\$69,273.60)**, if Tenant exercises its right to terminate the Lease with respect to Suite 400 on September 30, 2010.

1.6 RENT. The "Rent" reserved under this Lease, for the Term thereof, shall consist of the following:

- (a) "Base Rent" of as set forth in the Table in § 1.3 for the various spaces and periods described therein per month, which shall be payable in advance on the first day of each and every calendar month during the Term of this Lease; and
- (b) "Additional Rent" consisting of any and all other sums of money as shall become payable by Tenant to Landlord hereunder; and Landlord shall have the same remedies for default in the payment of Additional Rent as for a default in payment of Base Rent.

1.6.1 Payment of Rent. Tenant shall pay the Base Rent and Additional Rent promptly when due, without demand therefor and without any abatement, deduction, or setoff whatsoever, except as may be expressly provided in this Lease. Tenant shall pay the Rent to Landlord, in lawful money of the United States of America, at Landlord's office at the Complex or at such other place, or to such agent and at such place, as Landlord may designate by notice to Tenant. If the Commencement Date or Expiration Date occurs on a day other than the first or last day of a calendar month respectively, the Base Rent for such calendar month shall be prorated based on a 30-day month, and the balance of the first or last month's Base Rent theretofore paid shall be credited against the next monthly installment of Base Rent or refunded to Tenant within thirty (30) days following the Expiration Date.

1.6.2 Interest and Late Charges. Tenant acknowledges that the late payment of any monthly Rent will cause Landlord to lose the use of that money and incur costs and expenses not contemplated under this Lease, including administrative and collection costs and processing and account expenses, the exact amount of which it is difficult to ascertain. Therefore, if any such installment is not received by Landlord within five (5) days from the date it is due, Tenant shall pay Landlord a late charge equal to five percent (5%) of such installment. Landlord and Tenant agree that this late charge represents a reasonable estimate of such costs and expenses and is fair compensation to Landlord for the loss suffered from such nonpayment by Tenant. In addition, any check returned by the bank for any reason will be considered late and will be subject to all late charges plus an additional returned check fee of Twenty Dollars (\$20.00). After two such occasions upon which checks have been returned in any twelve-month period, Landlord will have the right to require payment by a cashier's check or money order. Acceptance of any late charge shall not constitute a waiver of Tenant's default with respect to such nonpayment by Tenant nor prevent Landlord from exercising any other rights or remedies available to Landlord under this Lease or at law or in equity, unless the payment of such late charges is accompanied by all rentals then due and owing (notwithstanding anything to the contrary in § 20.2.1 below).

1.6.3 Suite 400 Base Rent Abatement. Notwithstanding anything to the contrary in this § 1.6 or § 1.3 above, beginning with the Commencement Date for Suite (targeted for **February 1, 2004**), Tenant's Monthly Installment of Base Rent with respect to Suite 400 only shall be abated for a period of eighteen (18) months after the Existing Premises Termination Date (the "Abatement Period"). If Tenant shall materially default under the Lease and fail to cure within the time permitted for cure thereunder, while the Abatement Period is still in effect, the Abatement Period shall thereupon

terminate, and Tenant shall commence paying the Base Rent under the Lease as specified in the Table.

1.7 PROPERTY. For the purposes of this Lease, the "Property" shall mean the Building and any common or public areas or facilities, easements, corridors, lobbies, sidewalks, loading areas, driveways, landscaped areas, skywalk, parking garages and lots, and any and all other structures or facilities operated or maintained in connection with or for the benefit of the Building, and all parcels or tracts of land on which all or any portion of the Building or any of the other foregoing items are located, and any fixtures, machinery, equipment, apparatus, Systems and Equipment (as defined in § 1.7.5 below), furniture and other personal property located thereon or therein and used in connection therewith, whether title is held by Landlord or its affiliates. The Property shall also be deemed to include such other of the Complex's buildings or structures (and related facilities and parcels on which the same are located) as Landlord shall have incorporated by reference to the total square footage of the Building stated in § 1.4 above.

1.7.1 Common Areas. Tenant and its agents, employees, and invitees shall have the non-exclusive right with others designated by Landlord to the free use of the common areas in the Property and the Complex for the common areas' intended and normal purpose. The term *common areas* shall include (without limitation) elevators, sidewalks, parking areas, driveways, hallways, stairways, public restrooms, common entrances, lobbies, and other similar public areas and access ways.

1.7.2 Athletic Facility. Notwithstanding the foregoing, the common areas do not include the Building's athletic facility (the "Athletic Facility"), which is an unsupervised and unattended weight and exercise room and shower facility. Tenant acknowledges that Landlord presently makes available (but is not obligated under this Lease to make available) the Athletic Facility for the general use of all tenants and their officers and employees, subject to such rules and regulations as Landlord may impose from time to time in its sole and absolute discretion regarding the use thereof. Tenant shall cause each of its officers and employees using the Athletic Facility to sign and deliver to Landlord an "Athletic Facility Use Agreement" substantially in the form attached hereto as **Exhibit D**. Tenant understands and agrees that no individual shall be permitted use of or access to the Athletic Facility unless and until such individual shall have first signed and delivered the Athletic Facility Use Agreement to Landlord. Landlord shall have the right to limit the use of the Athletic Facility in any manner it may reasonably deem necessary, or to discontinue the Athletic Facility altogether, at any time, in its sole and absolute discretion, and neither Tenant nor its officers or employees shall be entitled to any compensation, credit, allowance, or offset of expenses or

Rent as a result of any such limitation or discontinuance, so long as at least one (1) similar athletic facility of no less than 3,000 square feet remains available for Tenant's use in the Complex. If Landlord elects to discontinue the Athletic Facility and does not provide a similar facility for Tenant's use in the Complex as provided in the foregoing sentence, (i) Landlord shall give Tenant a credit of Two Thousand Five Hundred Dollars (\$2,500.00) per month against the Base Rent due hereunder for so long as no such facility is available for Tenant's use in the Complex and (ii) Landlord shall permit Tenant upon request (and subject to the provisions of Article 9) to construct a facility similar to the Athletic Facility in Tenant's Premises, at Tenant's sole cost and expense.

1.7.3 Reservation to Landlord. Notwithstanding anything to the contrary herein, possession of areas necessary for utilities, services, safety, and operation of the Property, including the Systems and Equipment, telephone closets (whether located in the common areas or in the Premises), fire exits and stairways, perimeter walls, space between the finished ceiling of the Premises and the slab of the floor or roof of the Property thereabove, and the use thereof, together with the right to install, maintain, operate, repair, and replace any part of the Systems and Equipment in, through, under, or above the Premises in locations that will not materially interfere with Tenant's use of the Premises,

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are hereby excepted from both the Premises and the common areas and are reserved by Landlord and not demised to Tenant. Tenant's access to the telephone closets on each floor and the Building's main telephone room shall be subject to the Rules (as defined in § 13.1 below) and shall be permitted only with Landlord's written consent and under the supervision of Landlord's Building Engineer on each occasion that such access is sought.

1.7.4 Changes and Alterations of the Property. Landlord reserves the right to and shall make repairs, alterations, additions, or improvements, structural or otherwise, in or to the Property or Complex as deemed or are necessary or desirable in Landlord's reasonable discretion, so long as such repairs or alterations do not materially and unreasonably interfere with Tenant's access to or beneficial use of the Premises for their intended purposes. Notwithstanding anything to the contrary herein, Landlord agrees that it will not do or permit any core drilling in the Building without at least one (1) floor's separation from any affected portion of the Premises at any time during the business week (*i.e.*, Monday through Friday excluding Holidays) between the hours of 5:30 a.m. and 6:30 p.m. Landlord reserves the right hereunder to do the following: (i) install, use, maintain, repair, and replace pipes, ducts, conduits, wires, and appurtenant meters and equipment for service to the various parts of the Property above the ceiling surfaces, below the floor surfaces, within the walls, and in the central core areas; (ii) to relocate any pipes, ducts, conduits, wires, and appurtenant meters and equipment which are located in the Premises or located elsewhere outside the Premises; (iii) expand the Building or the Complex; (iv) make changes to the Property or the Complex, including changes, expansions, and reductions in the location, size, shape, and number of driveways, entrances, loading and unloading areas, ingress, egress, direction of traffic, landscaped areas, walkways, parking spaces, and parking areas; (v) close any of the common areas, so long as reasonable access to the Premises remains available; (vi) use the common areas while engaged in making additional improvements, repairs, or alterations to the Property, Complex, or any portion thereof; and (vii) do and perform such other acts and make such other changes in, to, or with respect to the Property, Complex, common areas, and Building as Landlord may deem appropriate. The exercise of any of the foregoing rights shall not subject Landlord to claims for constructive eviction, abatement of Rent, damages, or other claims of any kind, except as otherwise expressly provided in this Lease. If Landlord enters the Premises to exercise any of the foregoing rights, Landlord shall provide at least two (2) business days' advance written notice to Tenant's on-site manager, except (x) in cases of emergency and (y) for purposes of access to the Building roof for Landlord, its agents, and authorized licensees in cases where use of the stairs is either not possible or not reasonably practicable.

1.7.5 Systems and Equipment. As used in this Lease, "Systems and Equipment" means collectively any existing plant, machinery, transformers, duct work, intrabuilding network cables and wires that transmit voice, data, and other telecommunications signals ("INC"), and other equipment, facilities, and systems designed to supply water, heat, ventilation, air conditioning and humidity or any other services or utilities, or comprising or serving as any component or portion of the electrical, gas, steam, plumbing, sprinkler, communications, alarm, security, or fire/life/safety systems or equipment, or any other mechanical, electrical, electronic, computer or other systems or equipment for the Property.

2 USE

2.1 USE AND ENJOYMENT OF PREMISES. Tenant shall use and occupy the Premises for executive and general offices and for no other purpose. Notwithstanding anything contained herein to the contrary, Tenant may use portions of the Premises as shown on the approved Plans for the preparation and reheating of food and beverages, including the use of refrigerators, ice makers, coffee machines, hot

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plates, microwave ovens, or similar heating devices (but not for the actual cooking of food) for service only to Tenant's employees and business invitees.

2.1.1 Suitability. Tenant acknowledges that neither Landlord nor any agent of Landlord has made any representation or warranty with respect to the Premises, the Property, or the Complex, or with respect to the suitability of same for the conduct of Tenant's business, except as expressly provided in this Lease. Landlord makes no representation to Tenant regarding the installation, ownership, location, or suitability for Tenant's purposes of the INC in the Building.

2.1.2 Insurance Rates. Tenant shall not do or suffer anything to be done in or about the Premises, nor shall Tenant bring or allow anything to be brought into the Premises, which will in any way increase the rate of any fire insurance or other insurance upon the Property or its contents, cause a cancellation of said insurance, or otherwise affect said insurance in any manner.

2.1.3 Use to Comply with Laws. Tenant shall use the Premises in conformity with all applicable Laws, as specified in Article 6 below.

2.1.4 Floor Loading. Subject to and except as may be shown on Tenant's Plans, Tenant shall not place or permit to be placed on any floor a load exceeding eighty (80) pounds per square foot or such lower floor load as such floor was designed to carry.

2.2 NUISANCE AND WASTE. Tenant also shall not do or suffer anything to be done in or about the Premises which will in any way unreasonably obstruct or interfere with the rights of other tenants or occupants of the Property or injure said tenants or occupants, nor shall Tenant use or suffer the Premises to be used for any unlawful purposes. In no event shall Tenant cause or permit any nuisance in or about the Premises, and no loudspeakers or similar devices shall be used without the prior written approval of Landlord, which approval may be withheld in Landlord's reasonable discretion. Tenant shall not commit or suffer to be committed any waste in or upon the Premises. The provisions of this section are for the benefit of Landlord only and shall not be construed to be for the benefit of any tenant or occupant of the Building. If any governmental license or permit, other than a Certificate of Occupancy, shall be required for the proper and lawful conduct of Tenant's business in the Premises, or any part thereof, and if failure to secure such license or permit would in any way affect Landlord, Tenant, at its sole expense, shall procure and thereafter maintain such license or permit and submit the same for inspection by Landlord. Tenant shall at all times comply with the terms and conditions of each such license or permit.

2.3 COMPLIANCE WITH CERTIFICATE OF OCCUPANCY Tenant shall not at any time use or occupy the Premises, or suffer or permit anyone to use or occupy, the Premises, or do or permit anything to be done in the Premises, in violation of the Certificate of Occupancy for the Premises or for the Building.

3 PREPARATION OF THE PREMISES

3.1 CONDITION OF PREMISES. Except as otherwise expressly provided in § 3.2 below and the "Work Letter Agreement" which shall be executed by Landlord and Tenant concurrently with their execution of this Lease substantially in the form attached hereto as **Exhibit F**, Tenant shall accept the Premises, any existing Improvements in the Premises (as defined in § 10.1 below), and the Systems and Equipment serving the same in an "as is" condition on the date the Term commences, and Landlord shall have no obligation to improve, alter, remodel, or otherwise modify the Premises prior to Tenant's occupancy.

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3.2 LANDLORD'S PREPARATION. Landlord shall use reasonable diligence in completing and preparing the Premises for Tenant's occupancy in the manner and subject to the terms, conditions, and covenants set forth in the Work Letter Agreement. The facilities, materials, and work to be furnished, installed, and performed in the Premises by Landlord pursuant to the Work Letter Agreement are referred to as the "Work." Such other installations, materials, and work which may be undertaken by or for the account of Tenant to prepare, equip, decorate, and furnish the Premises for Tenant's occupancy are referred to as the "Tenant's Work." Landlord and Tenant agree that Landlord's Work specified in the Work Letter Agreement shall include the following items:

- (i) **Moving Allowance.** In addition to the Improvement Allowance specified in the Work Letter Agreement, Landlord shall pay to Tenant a moving allowance of _____ to be applied to the cost of relocating and installing Tenant's furniture, cubicles, network, and telephone equipment, which moving allowance Landlord shall pay to Tenant within thirty (30) days following Tenant's submittal of paid receipts, vouchers, and such other documentation as Landlord may reasonably request; and
- (ii) **Supplemental HVAC.** Landlord at its sole cost and expense shall hire a mechanical engineer to design in cooperation with Tenant's architects and consultants the HVAC system proposed for Tenant to address the western exposure of Tenant's office space. Landlord shall install a supplemental HVAC system in accordance with the Work Letter Agreement to cover one (1) entire wing of the three (3) wings of the fifth floor space to accommodate Tenant's extended hours business (the "Southeast Wing HVAC") and a portion of a second wing to accommodate after-hours operation of Tenant's data/server rooms (the "Data Rooms HVAC") (collectively the "Supplemental HVAC System"). Landlord agrees that CalAir shall be an approved vendor for Tenant's Supplemental HVAC System construction and one of the approved bidders for the overall HVAC work to be completed as part of Landlord's Work. Pricing, cost allocation, and scope of the 5th floor Supplemental HVAC System are addressed in the Work Letter Agreement.

3.2.2 Readiness for Occupancy. The Premises shall be deemed ready for occupancy on the earliest date on which all of the following conditions (the "Occupancy Conditions") have first been met:

- (a) **Substantial Completion of Work.** The Work has been substantially completed; and it shall be so deemed notwithstanding the fact that minor or insubstantial details of construction, mechanical adjustment, or decoration remain to be performed, the noncompletion of which does not materially interfere with Tenant's beneficial use of the Premises for their intended purposes;
- (b) **Access and Services.** Reasonable means of access and facilities necessary to Tenant's use and occupancy of the Premises, including corridors, elevators, stairways, heating, ventilating, air-conditioning, sanitary, water, and electrical facilities (but exclusive of parking facilities) have been installed and are in reasonably good operating order and available to Tenant; and
- (c) **Certificate of Occupancy or Completion.** A certificate of occupancy, certificate of completion, final inspection card, or similar required governmental approval (temporary or final) has been issued by the City of South San Francisco permitting use of the Premises for office purposes.

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The parties anticipate that Substantial Completion of Landlord's Work in Suite _____ shall occur on or before **February 1, 2004** (the "Target Date") and that Substantial Completion of Landlord's Work in Suite **400** shall occur on or before **August 1, 2004** (the "Suite 400 Target Date").

3.2.3 Tenant Delays. If the occurrence of any of the Occupancy Conditions and Landlord's preparation of the Premises for occupancy shall be delayed owing materially to either (a) any act, omission, or failure of Tenant or any of its employees, agents, or contractors which shall continue after Landlord shall have given Tenant reasonable notice that such act, omission, or failure would result in delay, and such delay shall have been unavoidable by Landlord in the exercise of reasonable diligence and prudence; or (b) the nature of any items of additional work or change orders that Landlord undertakes to perform for the account of Tenant (including any delays incurred by Landlord, after making reasonable efforts, in procuring any materials,

equipment, or fixtures of a kind or nature not used by Landlord as part of its standard construction) (collectively "Tenant Delays"), then the Premises shall be deemed ready for occupancy on the date when they would have been ready but for such Tenant Delays.

3.3 EARLY ENTRY. During any period that Tenant shall be permitted to enter the Premises prior to the Commencement Date other than to occupy the same (e.g., to perform alterations or improvements), Tenant shall comply with all terms and provisions of this Lease, except those provisions requiring the payment of Rent. If Tenant shall be permitted to enter the Premises prior to the Commencement Date for the purpose of occupying the same, Rent shall commence on the date Tenant commences business operations from the Premises at the rate specified in the Table for the first period during which Rent is payable after the Commencement Date; and if Tenant shall commence occupying only a portion of the Premises prior to the Commencement Date, Rent shall be prorated based on the number of rentable square feet occupied by Tenant. Landlord shall permit early entry, provided the Premises are legally available and Landlord has completed any Work required under this Lease. In no event shall Tenant's early entry extend or shorten the Term of the Lease set forth in § 1.2 above. Landlord agrees that, subject to the provisions of this Article 3, Tenant's telecommunication vendors shall have the right to install Tenant's telephone and data lines in Suite as soon as the walls are roughed out in anticipation of Tenant's move into Suite on or after the Commencement Date, provided such vendors shall not delay or interfere in the construction of the Work.

3.4 NOTICE OF DEFECTS. It shall be conclusively presumed upon Tenant's taking actual possession of the Premises that the same were in satisfactory condition (except for latent defects and punchlist items) as of the date of such taking of possession, unless with respect to punchlist items within thirty (30) days after the Commencement Date and within thirty (30) after discovery with respect to latent defects Tenant shall give Landlord notice in writing specifying the respects in which the Premises were not in satisfactory condition.

4 ADJUSTMENTS OF RENT

4.1 TAXES, UTILITIES, AND OPERATING EXPENSES. In addition to the Base Rent and all other payments due under this Lease, Tenant shall pay to Landlord, in the manner set forth in this Article 4, as Additional Rent, the following amounts:

- (a) **Increased Operating Expenses.** An amount equal to Tenant's Pro Rata Share of that portion of Operating Expenses paid by Landlord during each Adjustment Period which exceeds the amount of Base Operating Expenses (as all of such terms are defined in § 4.2 below).

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- (b) **Increased Utilities.** An amount equal to Tenant's Pro Rata Share of that portion of Utilities paid by Landlord during each Adjustment Period which exceeds the amount of Base Utilities (as all of such terms are defined in § 4.2 below).
 - (c) **Increased Taxes.** An amount equal to Tenant's Pro Rata Share of that portion of Real Estate Taxes paid by Landlord during each Adjustment Period which exceeds the amount of Base Real Estate Taxes (as all of such terms are defined in § 4.2 below).

Tenant's Pro Rata Share of (i) such increase in Operating Expenses over the Base Operating Expenses, (ii) such increase in Utilities over Base Utilities, and (iii) such increase in Real Estate Taxes over the Base Real Estate Taxes is sometimes referred to collectively herein as the "Rental Adjustment."

4.2 DEFINITIONS. For the purposes of this Lease, the following definitions shall apply:

- (a) **Base Operating Expenses.** "Base Operating Expenses" means the total of Operating Expenses paid by Landlord during **calendar year 2004** (the "Base Expense Year"), as adjusted under § 4.6 below.
- (b) **Base Utilities.** "Base Utilities" means the total of Utilities paid by Landlord during **calendar year 2004** (the "Base Utilities Year"), as adjusted under § 4.6 below.
- (c) **Base Real Estate Taxes.** "Base Real Estate Taxes" means the total of Real Estate Taxes paid by Landlord during **calendar year 2004** (the "Base Tax Year").
- (d) **Tenant's Pro Rata Share.** "Tenant's Pro Rata Share" as to the Building is the percentage labeled as such in the Table in § 1.3 and is calculated by dividing the agreed rentable area of the Premises (numerator) by the agreed rentable area of the Property (denominator) and expressing the resulting quotient as a percentage. "Tenant's Pro Rata Share" as to the Complex is the percentage labeled as such in the Table in § 1.3 as is calculated by dividing the agreed rentable area of the Premises (numerator) by the agreed rentable area of the Complex (denominator) and expressing the resulting quotient as a percentage. Tenant's Pro Rata Share shall be adjusted during the Term in proportion to any change in the area of the Premises, Building, or Complex in accordance with the formula stated herein.
- (e) **Adjustment Period.** "Adjustment Period" as to Operating Expenses, Utilities, and Real Estate Taxes means each calendar year of which any portion occurs during the Term, excluding the Base Year and beginning with the first calendar year immediately following the Base Year.
- (f) **Real Estate Taxes.** "Real Estate Taxes" means all of the following charges, whether or not now customary or in the contemplation of the parties hereto, and whether or not general, special, ordinary, or extraordinary, which Landlord shall pay during any Adjustment Period because of or in connection with the ownership, leasing, or operation of the Property:
 - (1) *ad valorem* real property taxes;
 - (2) any form of assessment, license fee, license tax, business license fee, commercial rental tax, levy, charge, fee, tax, or other imposition imposed by any authority, including any city, county, state, or federal governmental

agency, or any school, agricultural, lighting, transportation, housing, drainage, or other improvement or special assessment district thereof;

- (3) any tax on Landlord's 'right' to rent or 'right' to other income from the Building or as against Landlord's business of leasing the Building;
- (4) any assessment, tax, fee, levy, or charge in substitution, partially or totally, of any assessment tax, fee, levy or charge previously included within the definition of Real Estate Taxes, it being acknowledged by Tenant and Landlord that Proposition 13 was adopted by the voters of the State of California in the Election of June, 1978, and that assessments, taxes, fees, levies, and charges may be imposed by governmental agencies for such services as fire protection, street, sidewalk, and road maintenance, refuse removal, and for other governmental services formerly provided without charge to property owners or occupants, and it being the intention of Tenant and Landlord that all such new and increased assessments, taxes, fees, levies, and charges be included within the definition of Real Estate Taxes for the purposes of this Lease;
- (5) any assessment, tax, fee, levy, or charge allocable to or measured by the area of the Building or Property or the Rent payable hereunder, including any gross income tax or excise tax levied by any city, county, state, or federal governmental agency or any political subdivision thereof with respect to the receipt of such Rent, or upon or with respect to the possession, leasing, operating, management, maintenance, alteration, repair, use, or occupancy by Tenant of the Property or any portion thereof;
- (6) any assessment, tax, fee, levy, or charge upon this transaction or any document to which Tenant is a party, creating or transferring an interest or an estate in the Building or Property;
- (7) any assessment, tax, fee, levy, or charge by any governmental agency related to any transportation plan, fund, or system instituted within the geographic area of which the Building is a part; or
- 8) reasonable legal and other professional fees, costs and disbursements incurred in connection with proceedings to contest, determine or reduce Real Estate Taxes.

Exclusions. Notwithstanding the foregoing, Real Estate Taxes shall not include (A) federal, state, or local income taxes; (B) franchise, gift, transfer, excise, capital stock, estate, succession, or inheritance taxes; or (C) penalties or interest for late payment of Real Estate Taxes.

- (g) **Operating Expenses.** "Operating Expenses" means all expenses, costs, and amounts (other than Real Estate Taxes and Utilities) of every kind and nature which Landlord shall pay during any Adjustment Period of which any portion occurs during the Term, because of or in connection with the ownership, management, repair, maintenance, restoration, and/or operation of the Property. Operating Expenses shall be calculated in accordance with generally-accepted accounting principles, consistently applied, except to the extent that any other method of

calculation or characterization shall expressly be permitted hereunder, including costs of the following:

- (1) permits, licenses, and certificates necessary to operate, manage, and lease the Property;
- (2) supplies, tools, equipment, and materials used in the operation, repair, and maintenance of the Property;
- (3) all insurance premiums for any insurance policies deemed necessary or desirable by Landlord (including workers' compensation, health, accident, group life, public liability, property damage, earthquake, and fire and extended coverage insurance for the full replacement cost of the Property as required by Landlord or its lenders for the Property);
- (4) the deductible portion of any claim paid under any insurance policy other than any earthquake policy maintained by Landlord in connection with its management and operation of the Property;
- (5) reasonable accounting, legal, inspection, consulting, concierge, and other similar services;
- (6) services of independent contractors;
- (7) compensation (including employment taxes and fringe benefits) of all persons who perform duties in connection with the operation, maintenance, repair, or overhaul of the Building or Property, and equipment, improvements, and facilities located within the Property, including engineers, janitors, painters, floor waxers, window washers, security, parking personnel, and gardeners;
- (8) operation and maintenance of a room for delivery and distribution of mail to tenants of the Building as required by the U.S. Postal Service (including an amount equal to the fair market rental value of the mail room premises);
- (9) management of the Building or Property, whether managed by Landlord or an independent contractor (including an amount equal to the fair market value of any on-site manager's office), provided that such amount shall not exceed the management fee that would be charged by a third-party manager if the Property is managed by Landlord or an affiliate of Landlord;
- (10) rental expenses for (or a reasonable depreciation allowance on) personal property used in maintenance, operation, or repair of the Property and installment equipment purchase or equipment financing agreements for such personal property;

- (11) costs, expenditures, or charges (whether capitalized or not) required by any governmental or quasi-governmental authority after the Commencement Date;
- (12) payments to a third party under any easement, operating agreement, declaration, restrictive covenant, or instrument pertaining to the sharing of costs in any planned development;

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- (13) amortization of capital expenses (including financing costs) incurred by Landlord after the Commencement Date in order to (A) comply with Laws, (B) reduce Property Operating Expenses or Utilities, or (C) upgrade the utility, efficiency, or capacity of any utility or telecommunication systems serving tenants of the Property, provided that, as to (B) and (C), such expenses shall be included only to the extent of the savings generated thereby;
 - (14) operation, repair, and maintenance of all Systems and Equipment and components thereof (including replacement of components); janitorial service; alarm and security service; window cleaning; trash removal; elevator maintenance; cleaning of walks, parking facilities, and building walls; removal of ice and snow; replacement of wall and floor coverings, ceiling tiles, and fixtures in lobbies, corridors, restrooms and other common or public areas or facilities; maintenance and repair of the roof and exterior fabric of the Building, including replacement of glazing as needed; maintenance and replacement of shrubs, trees, grass, sod, and other landscaped items, irrigation systems, drainage facilities, fences, curbs, and walkways; repaving and restriping parking facilities; and roof repairs;
 - (15) the operation of any on-site maintenance shop(s) and the operation and maintenance of the Athletic Facility, any other fitness center, conference rooms, and all other common areas and amenities in the Property;
 - (16) provision of shuttle busses, shuttle services, and drivers between the Complex and BART and SFO airport, as required by the Bay Area Regional Transportation Act and deed covenants and restrictions applicable to the Complex; and
 - (17) any other costs or expenses reasonably incurred by Landlord which are reasonably necessary to operate, repair, manage, and maintain the Building and Property in a first-class manner and condition and which are not otherwise reimbursed by tenants of the Building.
- (h) **Utilities.** "Utilities" means all expenses, costs, and amounts of every kind and nature which Landlord shall pay during any Adjustment Period of which any portion occurs during the Term, because of or in connection with the electricity, power, gas, steam, oil or other fuel, water, sewer, lighting, heating, air conditioning, and ventilating delivered to or consumed or used in or on the Property.

4.2.1 Exclusions from Operating Expenses. Notwithstanding anything to the contrary herein, Operating Expenses shall not include (A) depreciation, interest, and amortization on Superior Mortgages (as defined in § 18.1 below), and other debt costs or ground lease payments, if any; (B) legal fees in connection with leasing, tenant disputes, or enforcement of leases; (C) real estate brokers' leasing commissions; (D) improvements or alterations to tenant spaces; (E) the cost of providing any service directly to, and reimbursed or paid directly by, any tenant; (F) any costs expressly excluded from Operating Expenses elsewhere in this Lease; (G) costs of any items to the extent Landlord receives reimbursement from insurance proceeds or from a third party (such proceeds to be deducted from Operating Expenses in the year in which received); (H) capital expenditures, except those expressly permitted above; provided, all such permitted capital expenditures (together with reasonable financing charges) shall be amortized for purposes of this

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Lease over the shorter of (x) their useful lives or (y) the period during which the reasonably estimated savings in Operating Expenses equals the expenditures. The following specific categories of expenses are also excluded hereunder from the definition of Operating Expenses:

- (a) Real Estate Taxes;
- (b) leasing commissions, costs, disbursements, and other expenses incurred for leasing, renovating, or improving space for tenants;
- (c) costs (including permit, license, and inspection fees and tenant improvement allowances) incurred in renovating, improving, decorating, painting, or redecorating vacant space or space for tenants;
- (d) Landlord's cost of electricity or other service sold to tenants for which Landlord is to be reimbursed as a charge over the Rent and Additional Rent payable under the lease with that tenant;
- (e) except as otherwise expressly permitted hereunder, costs incurred by Landlord for alterations that are considered capital improvements and replacements under generally-accepted accounting principles consistently applied;
- (f) depreciation and amortization on the Building except as expressly permitted elsewhere in the Lease;
- (g) except as otherwise expressly permitted hereunder, costs of a capital nature including capital improvements, capital repairs, capital equipment, and capital tools, as determined under generally-accepted accounting principles consistently applied;
- (h) costs incurred because Landlord or another tenant violated the terms of any lease;

- (i) overhead and profit paid to subsidiaries or affiliates of Landlord for management or other services on or to the Property or for supplies or other materials, to the extent that the costs of the services, supplies, or materials exceed the amount customarily charged by an independent entity for such services, supplies, or materials;
- (j) interest on debt or amortization payments on mortgages or deeds of trust or any other debt for borrowed money;
- (k) compensation paid to clerks, attendants, or other persons in commercial concessions operated by Landlord;
- (l) rentals and other related expenses incurred in leasing air conditioning systems, elevators, or other equipment ordinarily considered to be of a capital nature, except equipment used in providing janitorial services that is not affixed to the Building;
- (m) items and services for which Tenant reimburses Landlord or pays third parties or that Landlord provides selectively to one or more tenants of the Building other than Tenant without reimbursement;

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- (n) advertising and promotional expenditures;
 - (o) repairs or other work needed because of fire, windstorm, or other casualty or cause insured against by Landlord or to the extent Landlord's insurance required under the Lease would have provided insurance, whichever is the greater coverage;
 - (p) costs incurred in operating the parking facilities for the Building except to the extent the cost of operating the parking facilities exceeds the revenues generated from operating the parking facilities;
 - (q) nonrecurring costs incurred to remedy structural defects in original construction materials or installations;
 - (r) any costs, fines, or penalties incurred because Landlord violated any governmental rule or authority;
 - (s) costs incurred to test, survey, cleanup, contain, abate, remove, or otherwise remedy Hazardous Material in, on, or under the Property unless the Hazardous Material were in, on, or under the Property because of Tenant's negligence or intentional acts;
 - (t) costs incurred to comply with the Americans with Disabilities Act, except to the extent compliance is required because of amendments to the ADA which amendment(s) became effective after the date this Lease is signed;
 - (u) costs for sculpture, paintings, or other art beyond what is customary and usual commercial practice in the vicinity of the Building; and
 - (v) except as otherwise expressly permitted hereunder, other expenses that under generally-accepted accounting principles consistently applied would not be considered normal maintenance, repair, management, or operation expenses.

4.3 MANNER OF PAYMENT. To provide for current payments of the Rental Adjustment, Tenant shall pay as Additional Rent during each Adjustment Period an amount equal to Landlord's estimate of the Rental Adjustment which will be payable by Tenant for such Adjustment Period. Such payments shall be made in monthly installments, commencing on the first day of the month following the month in which Landlord notifies Tenant of the amount it is to pay hereunder and continuing until the first day of the month following the month in which Landlord gives Tenant a new notice of the estimated Rental Adjustment. It is the intention hereunder to estimate from time to time the amount of Tenant's Rental Adjustment for each Adjustment Period and then to effect a reconciliation in the following year based on the actual expenses incurred for the preceding Adjustment Period, as provided in 4.4 below.

4.4 RECONCILIATION. On or before the first day of April of each year after the first Adjustment Period (or as soon thereafter as is practical), Landlord shall deliver to Tenant a statement (the "Statement") setting forth the Rental Adjustment for the preceding year. If the actual Rental Adjustment for the preceding Adjustment Period exceeds the total of the estimated monthly payments made by Tenant for such Adjustment Period, Tenant shall pay Landlord the amount of the deficiency within ten (10) business days of the receipt of the Statement. If such total of estimated payments made exceeds the actual Rental Adjustment for such Adjustment Period, then Tenant shall receive a refund for the difference within ten (10) business days. If the credit is due from Landlord on the Expiration Date, Landlord shall pay Tenant

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the amount of the credit, less any Rent then due. The obligations of Tenant and Landlord to make payments required under this § 4.3 shall survive the expiration or earlier termination of the Term of this Lease.

4.4.1 Changes in Method. So long as Tenant's obligations hereunder are not materially adversely affected thereby, Landlord reserves the right reasonably to change the manner or timing of the foregoing payments. In lieu of providing one Statement covering Real Estate Taxes, Utilities, and Operating Expenses, Landlord may provide separate statements, at the same or different times. No delay by Landlord in providing the Statement (or separate statements) shall be deemed a default by Landlord or a waiver of Landlord's right to require payment of Tenant's obligations for actual or estimated Real Estate Taxes, Utilities, or Operating Expenses. Subject to § 4.7 below, in no event shall a decrease in Real Estate Taxes, Utilities, or Operating Expenses below the Base Operating Expenses, Base Utilities, or Base Real Estate Taxes ever decrease the monthly Base Rent or give rise to a credit in favor of Tenant.

4.4.2 Proration of Rental Adjustment. If the Term does not commence on January 1 or does not end on December 31, Tenant's obligations to pay estimated and actual amounts towards Real Estate Taxes, Utilities, and Operating Expenses for such first or final calendar year shall be prorated to

reflect the portion of such year(s) included in the Term. Such proration shall be made by multiplying the total estimated or actual (as the case may be) Real Estate Taxes, Utilities, and Operating Expenses for such calendar year(s), as well as the Base Real Estate Taxes, Base Utilities, and Base Operating Expenses, by a fraction, the numerator of which shall be the number of days of the Term during such calendar year, and the denominator of which shall be three hundred sixty-five (365).

4.5 GROSS-UP. If the Building or Complex is less than ninety-five percent (95%) occupied during any Adjustment Period, then Operating Expenses, Utilities, and Real Estate Taxes for such Adjustment Period shall be “grossed up” to that amount of Operating Expenses, Utilities, and Real Estate Taxes that, using reasonable projections, would normally have been incurred during such Adjustment Period if the Building or Complex had been ninety-five percent (95%) occupied during the Adjustment Period. Only those component elements or items of expense of Operating Expenses, Utilities, and Real Estate Taxes that are affected by variations in occupancy levels shall be grossed up.

4.6 ADJUSTMENT OF BASE OPERATING EXPENSES. Notwithstanding anything to the contrary contained in the Lease, the parties agree that Base Operating Expenses and Operating Expenses for any subsequent Adjustment Period (herein called “Subsequent Operating Expenses”) shall be subject to further adjustment by Landlord as follows:

- (a) **Exclusion of Capital Expenditures.** Landlord may exclude from Base Operating Expenses capital expenditures otherwise permitted, provided Landlord shall also exclude any amortization of such expenditures from Subsequent Operating Expenses.
- (b) **Elimination of Recurring Expenses.** If Landlord eliminates from any Subsequent Operating Expenses a category of recurring expenses previously included in Base Operating Expenses, Landlord may subtract such category from Base Operating Expenses commencing with such subsequent Adjustment Period.
- (c) **New Recurring Expenses.** If Landlord includes a new category of recurring Subsequent Operating Expenses not previously included in Base Operating Expenses, Landlord shall also include an amount (the “Assumed Base Amount”)

for such category in Base Operating Expenses commencing in such subsequent Adjustment Period.

- (d) **Assumed Base Amount.** The “Assumed Base Amount” under § 4.6(c) above shall be the annualized amount of expenses for such new category in the first Adjustment Period it is included, reduced by an amount determined in Landlord’s sole good faith discretion (but in no event by an amount less than five percent (5%)) for each full or partial Adjustment Period that has elapsed during the Term of the Lease before such Adjustment Period.

4.7 ADJUSTMENT OF REAL ESTATE TAXES. If Base Real Estate Taxes are reduced as the result of protest, by means of agreement, as the result of legal proceedings, or otherwise, Landlord may adjust Tenant’s obligations for Real Estate Taxes in all years affected by any refund of taxes following the Base Tax Year; and Tenant shall pay Landlord within thirty (30) days after notice any additional amount required by such adjustment for any Adjustment Periods that have theretofore occurred. Tenant shall be entitled to receive a share of any refund or abatement of Real Estate Taxes received by Landlord to the extent of and in proportion to Tenant’s actual contribution to the amount of Real Estate Taxes paid by Landlord during the period to which such refund or abatement relates; and in addition Landlord agrees to give Tenant an equitable credit against the total amount of Additional Rent that would otherwise be due hereunder to the extent that any reassessment (other than a reassessment triggered by a sale of the Building or Property) reduces the annual amount of Real Estate Taxes payable by Landlord with respect to the Building or Property and such Real Estate Taxes were allocated to the computation of Tenant’s Base Year Real Estate Taxes hereunder. If Real Estate Taxes for any Adjustment Period during the Term or any extension thereof shall be increased after payment thereof by Landlord for any reason, including error or reassessment by applicable governmental authorities, Tenant shall pay Landlord upon demand Tenant’s Pro Rata Share of such increased Real Estate Taxes. Tenant shall pay increased Real Estate Taxes whether Real Estate Taxes are increased as a result of increases in the assessment or valuation of the Property (whether based on a sale, change in ownership, refinancing of the Property, or otherwise), increases in the tax rates, reduction or elimination of any rollbacks or other deductions available under current law, scheduled reductions of any tax abatement, as a result of the elimination, invalidity, or withdrawal of any tax abatement, or for any other cause whatsoever. Notwithstanding the foregoing, if any Real Estate Taxes shall be paid based on assessments or bills by a governmental authority using a fiscal year other than a calendar year, Landlord may elect to average the assessments or bills for the subject calendar year, based on the number of months of such calendar year included in each such assessment or bill.

4.7.1 Tax Increases after a Property Transfer. Notwithstanding anything to the contrary contained herein, in the event the Property is sold or otherwise transferred during the initial term of this Lease (the “Sale”), and the assessed value of the Property is increased as a result of the Sale, only the following percentages of any increase in Real Property Taxes above the Base Year Real Property Taxes resulting from such increase in assessed valuation shall be included in Real Property Taxes for purposes of determining Additional Rent:

If the Sale Occurs	Percentage of Increased Real Property Taxes Applicable For Remainder of the Lease Term
Prior to first anniversary of Commencement Date	Zero
On or after first anniversary of Commencement Date but prior to second anniversary of Commencement Date	25%
On or after second anniversary of Commencement Date but prior to third anniversary of Commencement Date	50%
On or after third anniversary of Commencement Date but prior to fourth anniversary of Commencement Date	75%
On or after fourth anniversary of Commencement Date	100%

In addition, following any such Sale, the same restrictions specified in the above table shall again apply with respect to any subsequent Sale in determining the allowable amount of any increases in Real Property Taxes used to compute Tenant's Additional Rent under § 4.1 above, except that the time periods shall run from the date of any such Sale instead of from the Commencement Date.

4.8 ALLOCATION WITHIN COMPLEX. So long as the Property shall be part of the Complex collectively owned or managed by Landlord or its affiliates or collectively managed by Landlord's managing agent, Landlord shall allocate Real Estate Taxes, Utilities, and Operating Expenses within the Complex and between the buildings and structures comprising the Complex and the parcels on which they are located. In the alternative, Landlord shall have the right to determine Tenant's Pro Rata Share of Real Estate Taxes, Utilities, and Operating Expenses based upon the totals of each of the same for all such buildings and structures, the land constituting parcels on which the same are located, and all related facilities, including common areas and easements, corridors, lobbies, sidewalks, elevators, loading areas, parking facilities, driveways, and other appurtenances and public areas, in which event Tenant's Pro Rata Share shall be based on the ratio of the rentable area of the Premises to the rentable area of all buildings in the Complex.

4.9 LANDLORD'S RECORDS. Landlord shall maintain records with respect to Real Estate Taxes, Utilities, and Operating Expenses and determine the same. Although this Lease contemplates the computation of Real Estate Taxes, Utilities, and Operating Expenses on a cash basis, Landlord shall make reasonable and appropriate accrual adjustments (including adjustment of Base Year Real Estate Taxes, Utilities, and Operating Expenses) to ensure that each Adjustment Period includes substantially the same recurring items. Landlord reserves the right to change to a full accrual system of accounting so long as the same is consistently applied and Tenant's obligations are not materially adversely affected. Tenant or its representative shall have the right to examine such records, upon reasonable prior written notice specifying such records Tenant desires to examine, during normal business hours at the place or places where such records are normally kept, by sending such notice no later than forty-five (45) days following the furnishing of the Statement.

4.9.1 Tenant's Audit Right. Upon written notice to Landlord delivered within forty-five (45) days following the furnishing of the Statement, Tenant shall have the right to have Landlord's records with respect to Real Estate Taxes, Utilities, and Operating Expenses audited by an accountant of Tenant's choice. Tenant shall pay the cost of such audit, unless such audit determines that Tenant was overbilled for Real Estate Taxes, Utilities, or Operating Expenses by more than four percent (4%). Pending resolution of any such exceptions in the foregoing manner, Tenant shall continue paying Tenant's Pro Rata Share of Real Estate Taxes and Operating Expenses in the amounts determined by Landlord, subject to adjustment after any such exceptions are so resolved. Any specific matter that has formed the subject of an audit hereunder shall not be subject to re-audit at any subsequent time.

4.10 OTHER TAXES PAYABLE BY TENANT. In addition to the Base Rent and any other charges to be paid by Tenant hereunder, Tenant shall, as an element of Rent, reimburse Landlord upon demand for any and all taxes payable by Landlord (other than net income taxes) which are not otherwise reimbursable under this Lease, whether or not now customary or within the contemplation of the parties, where such taxes are upon, measured by, or reasonably attributable to (A) the cost or value of Tenant's equipment, furniture, fixtures, and other personal property located at the Premises, or the cost or value of any improvements made in or to the Premises by or for Tenant, regardless of whether title to such improvements is held by Tenant or Landlord; (B) the gross or net Rent payable under this Lease, including any rental or gross receipts tax levied by any taxing authority with respect to the receipt of the Rent hereunder; (C) the possession, leasing, operation, management, maintenance, alteration, repair, use, or occupancy by Tenant of the Premises or any portion thereof; or (D) this transaction or any document to which Tenant is a party creating or transferring an interest or an estate in the Premises. Tenant shall pay any rent tax, sales tax, service tax, transfer tax, value-added tax, or any other applicable tax on the Rent or services herein or otherwise respecting this Lease.

5 SECURITY DEPOSIT

5.1 DEPOSIT FOR SECURITY. Tenant shall deposit with Landlord the amount of **One Hundred Thousand Dollars (\$100,000)** in cash or by irrevocable standby letter of credit in form reasonably satisfactory to Landlord (the "Security Deposit") upon Tenant's execution and submission of this Lease. The Security Deposit shall serve as security for the prompt, full, and faithful performance by Tenant of the terms and provisions of this Lease. Landlord shall not be required to keep the Security Deposit separate from Landlord's general funds or pay interest on the Security Deposit.

5.1.1 Application of Deposit. In the event that Tenant is in Default hereunder and fails to cure within any applicable time permitted under this Lease, or in the event that Tenant owes any amounts to Landlord upon the expiration of this Lease, Landlord may use or apply the whole or any part of the Security Deposit for the payment of Tenant's obligations hereunder. The use or application of the Security Deposit or any portion thereof shall not prevent Landlord from exercising any other right or remedy provided hereunder or under any Law and shall not be construed as liquidated damages.

5.1.2 Restoration of Full Deposit. In the event the Security Deposit is reduced by such use or application, Tenant shall deposit with Landlord, within ten (10) business days after written notice, an amount sufficient to restore the full amount of the Security Deposit.

5.1.3 Disposition of Security Deposit. After the Expiration Date or any earlier termination of the Lease, any remaining portion of the Security Deposit shall be returned to Tenant in accordance with the provisions of § 1950.7 of the California Civil Code.

6 COMPLIANCE WITH LAWS

6.1 TENANT'S COMPLIANCE WITH LAWS. Tenant shall use the Premises in compliance with all applicable federal, state, county, and local governmental and municipal laws, statutes, ordinances, rules, regulations, codes, decrees, orders, and other such requirements, and decisions by courts in cases where such decisions are considered binding precedents in the State of California (the "State"), and decisions of federal courts applying the laws of the State applicable to Tenant's use of the Premises (collectively "Laws"). Tenant shall, at its sole cost and expense, promptly comply with each and all of such Laws, and also with the requirements of any board of fire underwriters or other similar body now or hereafter constituted to deal with the condition, use, or occupancy of the Premises, except in the case of required

structural changes not triggered by Tenant's change in use of the Premises or Tenant's alterations, additions, or improvements therein. Tenant shall comply with all applicable Laws regarding the physical condition of the Premises, but only to the extent that the applicable Laws pertain to the particular manner in which Tenant uses the Premises or the particular use to which Tenant puts the Premises, if different from that permitted under Article 2 of this Lease. Tenant shall also comply with all applicable Laws which do not relate to the physical condition of the Premises and with which only the occupant can comply, such as laws governing maximum occupancy, workplace smoking, VDT regulations, and illegal business operations, such as gambling. The judgement of any court of competent jurisdiction or the admission of Tenant in any judicial action, regardless of whether Landlord is a party thereto, that Tenant has violated any of such Laws shall be conclusive of that fact as between Landlord and Tenant.

6.1.1 Code Costs. Notwithstanding anything to the contrary in this Article 6, if the requirement of any public authority obligates either Landlord or Tenant to expend money in order to bring the Premises and/or any area of the Property into compliance with Laws as a result of (a) Tenant's particular use or alteration of the Premises; (b) Tenant's change in the use of the Premises; (c) the manner of conduct of Tenant's business or operation of its installations, equipment, or other property therein; (d) any cause or condition created by or at the instance of Tenant, other than by Landlord's performance of any work for or on behalf of Tenant; or (e) breach of any of Tenant's obligations hereunder, then Tenant shall bear all costs ("Code Costs") of bringing the Premises and/or Property into compliance with Laws, whether such Code Costs are related to structural or nonstructural elements of the Premises or Property.

6.2 LANDLORD'S COMPLIANCE WITH LAWS. Landlord represents that on the Commencement Date Landlord has no actual knowledge of any violation of any applicable Laws respecting the Premises. During the Term Landlord shall comply with all applicable Laws regarding the Premises, Building, Property, or Complex, except to the extent Tenant must comply under § 6.1 above.

7 HAZARDOUS MATERIALS

7.1 REGULATION OF HAZARDOUS MATERIALS. Tenant shall not transport, use, store, maintain, generate, manufacture, handle, dispose, release, or discharge any "Hazardous Material" (as defined below) upon or about the Property, nor permit Tenant's employees, agents, contractors, and other occupants of the Premises to engage in such activities upon or about the Property. However, the foregoing provisions shall not prohibit the transportation to and from, and use, storage, maintenance, and handling within, the Premises of substances customarily used in offices, provided all of the following conditions are met:

- (a) such substances shall be used and maintained only in such quantities as are reasonably necessary for such permitted use of the Premises, strictly in accordance with applicable Laws and the manufacturers' instructions therefor;
- (b) such substances shall not be disposed of, released, or discharged on the Property and shall be transported to and from the Premises in compliance with all applicable Laws, and as Landlord shall reasonably require;
- (c) if any applicable Laws or Landlord's trash removal contractor requires that any such substances be disposed of separately from ordinary trash, Tenant shall make arrangements at Tenant's expense for such disposal directly with a qualified and licensed disposal company at a lawful disposal site (subject to scheduling and approval by Landlord), and shall ensure that disposal occurs frequently enough to prevent unnecessary storage of such substances in the Premises; and

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- (d) any remaining such substances shall be completely, properly, and lawfully removed from the Property upon expiration or earlier termination of this Lease.

7.1.1 DEFINITION OF HAZARDOUS MATERIAL. The term "Hazardous Material" for purposes hereof shall mean any chemical, substance, material, or waste or component thereof which is now or hereafter listed, defined, or regulated as a hazardous or toxic chemical, substance, material, or waste or component thereof by any federal, state, or local governing or regulatory body having jurisdiction, or which would trigger any employee or community "right-to-know" requirements adopted by any such body, or for which any such body has adopted any requirements for the preparation or distribution of an MSDS.

7.2 NOTIFICATIONS. Tenant and Landlord each shall promptly notify the other of (A) any enforcement, cleanup, or other regulatory action taken or threatened by any governmental or regulatory authority with respect to the presence of any Hazardous Material on the Premises or in the Complex or the migration thereof from or to other property; (B) any demands or claims made or threatened by any party against Tenant or Landlord, as the case may be, or the Premises or Complex relating to any loss or injury resulting from any Hazardous Material on or from the Premises or Complex; and (C) any matters where Tenant or Landlord is required by law to give a notice to any governmental or regulatory authority respecting any Hazardous Material on the Premises or in the Complex, as the case may be. Landlord shall have the right (but not the obligation) to join and participate, as a party, in any legal proceedings or actions affecting the Premises initiated in connection with any environmental, health, or safety law.

7.3 LIST OF HAZARDOUS MATERIALS. At such times as Landlord may reasonably request, Tenant shall provide Landlord with a written list identifying any Hazardous Material then used, stored, or maintained upon the Premises, the use and approximate quantity of each such material, a copy of any material safety data sheet ("MSDS") issued by the manufacturer thereof, written information concerning the removal, transportation, and disposal of the same, and such other information as Landlord may reasonably require or as may be required by law.

7.4 CLEANUP. If any Hazardous Material is released, discharged or disposed of by Tenant or any other occupant of the Premises, or their employees, agents, or contractors, on or about the Property in violation of the foregoing provisions, Tenant shall immediately, properly, and in compliance with applicable Laws clean up and remove the Hazardous Material from the Property and any other affected property and clean or replace any affected personal property (whether or not owned by Landlord), at Tenant's expense. Such clean up and removal work shall be subject to Landlord's prior written approval (except in emergencies), and shall include any testing, investigation, and the preparation and implementation of any remedial action plan required by any governmental

body having jurisdiction or reasonably required by Landlord. If Tenant shall fail to comply with the provisions of this § 7.2 within such time as may be required by Laws or in order to minimize any hazard to persons or property, Landlord may (but shall not be obligated to) arrange for such compliance directly or as Tenant's agent through contractors or other parties selected by Landlord, at Tenant's expense (without limiting Landlord's other remedies under this Lease or applicable Laws).

7.5 CASUALTY DAMAGE. If any Hazardous Material is released, discharged, or disposed of on or about the Property and such release, discharge, or disposal is not caused by Tenant or other occupants of the Premises, or their employees, agents, or contractors, such release, discharge, or disposal shall be deemed casualty damage under Article 15 to the extent that the Premises or common areas serving the Premises are affected thereby; in such case, Landlord and Tenant shall have the obligations and rights respecting such casualty damage provided under Article 15 of this Lease.

7.6 REFRIGERANT. Except as specified in Tenant's Plans, Tenant shall not install any refrigerant-containing systems or equipment, including refrigerators, freezers, supplemental HVAC systems or self-contained air conditioners, without Landlord's prior approval, which Landlord may withhold in its reasonable discretion. Unless Tenant shall have obtained Landlord's prior written approval to install existing equipment after an inspection, at Tenant's sole cost and expense, by Landlord's engineer for defects and proper proposed installation in the Premises, all refrigerant-containing equipment and/or systems which Tenant installs in the Premises shall be new. Whether Tenant's refrigerant-containing equipment or systems are defective and are properly installed shall be determined at the sole discretion of Landlord's engineer. If Tenant wishes to install any refrigerant-containing equipment or systems, Tenant shall obtain and provide Landlord with copies of all required permits associated with such equipment or systems.

7.6.1 Removal of Refrigerant. Notwithstanding anything to the contrary in this Lease and the Work pursuant to Exhibit F, Tenant shall remove all refrigerant and refrigerant-containing equipment and/or systems installed in the Premises by or on behalf of Tenant prior to the Expiration Date of this Lease. Prior to the removal of any such refrigerant or refrigerant-containing equipment and/or systems, Tenant shall submit to Landlord for Landlord's approval, the names of Tenant's contractors and all plans and specifications for such removal. Tenant and Tenant's contractors shall comply with all legal requirements, industry practices and reasonable rules established by Landlord in performing such removal work. Tenant shall repair any damage to the Property or the Systems and Equipment associated with such removal, and Tenant shall be responsible for the costs associated with restoring the Property to the condition which existed immediately prior to any modification undertaken by Landlord in order to accommodate Tenant's refrigerant-containing equipment or systems.

8 SERVICES AND UTILITIES

8.1 LANDLORD'S SERVICES. Landlord agrees to provide, on the terms and conditions specified herein, the following services and utilities for Tenant's use and consumption in the Premises, the cost of which shall be included in Operating Expenses and/or Utilities and reimbursed to Landlord in accordance with § 4.1 above:

- (a) **Electricity.** Electricity for standard office lighting fixtures and for equipment and accessories customary for offices, provided (i) the connected electrical load of all the same does not exceed an average of seven point eight (7.8) watts per usable square foot of the Premises (or such lesser amount as may be available, based on the safe and lawful capacity of the existing electrical circuit(s) and facilities serving the Premises); (ii) the electricity will be at nominal 120 volts, single phase (or 110 volts, depending on available service in the Building); and (iii) the safe and lawful capacity of the existing electrical circuit(s) serving the Premises is not exceeded. Landlord will permit its electric feeders, risers, and wiring servicing the Premises to be used by Tenant to the extent available and safely capable of being used for such purpose.
- (b) **Telecommunications Interface.** Interface with the telephone network at the demarcation point or minimum point of entry ("MPOE") supplied by the local regulated public utility by means of Landlord's INC consisting of cable pairs with a capacity consistent with the engineering standards to which the Building was designed.
- (c) **HVAC.** Heat, ventilation, and air-conditioning ("HVAC") to provide a temperature required, under the specifications stated in the Plans and in accordance with applicable Laws, for the comfortable occupancy of the Premises during business hours (as defined in

§ 8.1.1 below). Landlord shall not be responsible for inadequate air-conditioning or ventilation to the extent the same occurs because Tenant uses any item of equipment consuming more than 500 watts at rated capacity without providing adequate air-conditioning and ventilation therefor. Notwithstanding anything to the contrary herein, Landlord agrees to engineer and calibrate, at its sole cost and expense, the 4th Floor portion of the Premises to address the special conditions associated with the Building's western exposure, and Tenant's architect or consultants shall be involved in the design and engineering of Tenant's HVAC systems. Landlord agrees that CalAir shall be an approved vendor for Tenant's Supplemental HVAC System and one of the approved bidders for the HVAC work to be completed as part of Landlord's Work under the Work Letter Agreement and as specified in § 3.2(ii) above. Notwithstanding anything to the contrary herein, Tenant shall maintain the Supplemental HVAC System to be installed in the 5th Floor of the Premises as specified in § 3.2(ii) above at Tenant's cost and expense. The cost to maintain the Supplemental HVAC System shall not be included within Operating Expenses. Tenant's Supplemental HVAC System shall be separately metered and separately controlled by Tenant, and the cost for Tenant's use of the Supplemental HVAC System shall be allocated as follows: (a) the cost of the Data Rooms HVAC during normal business hours shall be included in the services to be provided by Landlord hereunder, but Tenant shall be billed for after-hours use of its Data Rooms HVAC as provided in §§ 8.6.1 and 8.6.2

below; and (b) the cost of the Southeast Wing HVAC shall not be included in the services to be provided by Landlord hereunder, and Tenant shall be billed for all use of its Southeast Wing HVAC at all times (including normal business hours) as provided in §§ 8.6.1 and 8.6.2 below.

- (d) **Water.** Water for drinking, lavatory and toilet purposes at those points of supply provided for nonexclusive general use of other tenants at the Property.
- (e) **Janitorial Services.** Customary office cleaning and trash removal service Monday through Friday or Sunday through Thursday in and about the Premises.
- (f) **Elevator Services.** Operatorless passenger elevator service and freight elevator service (if the Property has such equipment serving the Premises, and subject to scheduling by Landlord) in common with Landlord and other tenants and their contractors, agents, and visitors.

8.1.1 Business Hours. The term *business hours* in this Lease shall mean the hours from 8:00 a.m. until 6:00 p.m. on Monday through Friday and from 9:00 a.m. until 1:00 p.m. on Saturday throughout the year, except for New Year's Day, Presidents' Day, Memorial Day, Independence Day, Labor Day, Thanksgiving Day, Christmas Day, and any other federally-observed holiday which may be created during the Term ("Holidays").

8.1.2 Separate Janitorial Services. Notwithstanding anything to the contrary herein, Tenant shall have the right, upon written notice to Landlord, to provide its own janitorial services to the Premises under a separate direct contract with a janitorial services provider subject to Landlord's reasonable approval, which shall not be unreasonably withheld, conditioned, or delayed. If Tenant elects to utilize any such separate janitorial services, Landlord shall give Tenant a credit against the Additional Rent due hereunder in the amount of any saving realized by Landlord in the cost of janitorial services provided by Landlord to the Building by virtue of Tenant's provision of such separate services; and any such separate janitorial services shall be excluded from Tenant's Base

Operating Expenses and each Adjustment Period during which Tenant separately contracts for its own janitorial services.

8.2 ADDITIONAL ELECTRICAL CAPACITY. Subject to Exhibit F, any additional risers, feeders, or other equipment or service proper or necessary to supply Tenant's electrical requirements will be installed by Landlord, upon written request of Tenant, at the sole cost and expense of Tenant, if, in Landlord's sole judgement, the same are necessary and will not cause permanent damage or injury to the Property, the Premises, or the Systems and Equipment or cause or create a dangerous or hazardous condition or entail excessive or unreasonable alterations, repairs, or expense or interfere with or disturb other tenants or occupants. Rigid conduit only will be allowed.

8.2.1 Approved Electrical Load. Tenant agrees not to connect any additional electrical equipment of any type to the building electric distribution system, beyond that on Tenant's approved plans for initial occupancy, other than lamps, typewriters, PCs, copy machines, and other office machines which consume comparable amounts of electricity or other electrical equipment which in the aggregate consumes the same amount of electricity as those approved for initial occupancy and will not result in any overload of electrical circuits, lines, or wiring, without Landlord's prior written consent. In no event shall Tenant use or install any fixtures, equipment, or machines the use of which in conjunction with other fixtures, equipment, and machines in the Premises would result in an overload or the electrical circuits servicing the Premises. Tenant covenants and agrees that at all times its use of electric current shall never exceed the capacity of the feeders to the Building or the risers or wiring installation existing at the time in question.

8.3 ADDITIONAL TELECOMMUNICATIONS CAPACITY. If Tenant desires any telecommunications capacity in excess of that available as of the Commencement Date in the form of the INC between the MPOE and the telephone closet nearest the Premises and provided pursuant to § 8.1 above, Tenant shall bear the cost of installing additional risers or INC or replacing existing INC serving the Premises pursuant to Article 9 below.

8.4 REPLACEMENT BULBS AND TUBES. Tenant shall furnish, install, and replace, as required, all non-Building-standard lighting tubes, lamps, bulbs, and ballasts required in the Premises, at Tenant's sole cost and expense. All lighting tubes, lamps, bulbs, and ballasts so installed become Landlord's property upon the expiration or sooner termination of this Lease. Landlord shall provide and install all Building-standard tubes, lamps, bulbs, and ballasts.

8.5 TWENTY-FOUR HOURS ACCESS. Subject to the provisions of § 8.8, Tenant, its employees, agents, and invitees shall have access to the Premises twenty-four (24) hours a day, seven (7) days a week. Landlord may restrict access outside of business hours by requiring persons to show a badge or identification card issued by Landlord. Landlord shall not be liable for denying entry to any person unable to show the proper identification. Landlord may without liability temporarily close the Building if required because of a life-threatening or Building-threatening situation; provided, however, that loss of power shall not be a Building-threatening or life-threatening situation. Landlord shall also provide Tenant with one (1) access card that will allow Tenant to gain entry through the front door of the Building, should the Building ever be locked for whatever reason.

8.6 EXTRA SERVICES. Landlord shall, subject to all applicable Laws, seek to provide such utilities or services in excess of those Landlord is required to provide under § 8.1 above as Tenant may from time to time request, if the same are reasonable and feasible for Landlord to provide and do not involve modifications or additions to the Property or the Systems and Equipment and if Landlord shall receive

Tenant's request within a reasonable period prior to the time such extra utilities or services are required. Landlord may comply with written or oral requests by any officer or employee of Tenant, unless Tenant shall notify Landlord of, or Landlord shall request, the names of authorized individuals (up to three (3) for each floor on which the Premises are located) and procedures for written requests. Tenant shall, for such extra utilities or services, pay such reasonable charges as Landlord shall from time to time establish.

8.6.1 Extraordinary Service Usage. If Tenant shall utilize Building services for the Premises at any time other than during business hours, Landlord shall furnish such extraordinary services (excluding air-conditioning, except as provided below) at Landlord's then-current prevailing rate for such services. In addition to the foregoing services, if Tenant shall require air-conditioning service for the Premises at any time other than during business hours, Landlord shall, upon reasonable advance notice from Tenant, furnish such after-hours air-conditioning service at Landlord's then-current prevailing rate for such services as a separate charge; provided, however, in the event Tenant requests such after-hours air-conditioning service at a time not immediately preceding or immediately succeeding times when "regular hours" service is being furnished hereunder, then, except for Tenant's use of the Supplemental HVAC System, Tenant must request not less than five (5) hours of after-hours air-conditioning service. Notwithstanding anything contained herein to the contrary, Landlord's prevailing rate for the extraordinary services described herein shall be subject to increase from time to time as Landlord may reasonably determine.

8.6.2 Payment for Excess Usage. All charges for extra utilities or services or those requested outside business hours shall be due at the same time as the installment of Base Rent with which the same are billed, or if billed separately, shall be due within twenty (20) days after such billing.

8.6.3 Changes in HVAC System. Use of the Premises, or any part thereof, in a manner exceeding the design conditions (including occupancy and connected electrical load) for the heating or cooling units in the Premises, or rearrangement of partitioning which interferes with normal operation of the HVAC system in the Premises, may require changes in the HVAC system servicing the Premises. Such changes shall be made by Tenant, at its expense, as Tenant's Changes pursuant to Article 9. Except for thermostats fitted with externally accessible adjustments, Tenant shall not change or adjust any closed or sealed thermostat or other element of the HVAC system without Landlord's express prior written consent.

8.6.4 Separate Metering. Landlord may install and operate meters or any other reasonable system for monitoring or estimating any services or utilities used by Tenant in excess of those required to be provided by Landlord under this Article 8 (including a system for Landlord's engineer reasonably to estimate any such excess usage). If such system indicates such excess services or utilities, Tenant shall pay Landlord's reasonable charges for installing and operating such system and any supplementary air-conditioning, ventilation, heat, electrical, or other systems or equipment (or adjustments or modifications to the existing Systems and Equipment), and Landlord's reasonable charges for such amount of excess services or utilities used by Tenant. If Tenant's use of extra utilities or services causes Landlord's regulated baseline quantities of water, gas, electricity, or any other utility or service to be exceeded, Tenant shall pay for such excess quantities of such utilities or services at the rate which is imposed upon Landlord for quantities in excess of the regulated baseline. In addition, Tenant shall pay prior to delinquency any fine or penalty which may be imposed upon or assessed against Landlord or the Building or the Property by virtue of Tenant's excess usage of any services or utilities, including water, gas, and electricity.

8.7 INTERRUPTION OF SERVICES. Landlord does not warrant that any services or utilities provided hereunder for Tenant's use in the Premises will be free from shortages, failures, variations, or

interruptions caused by repairs, maintenance, replacements, improvements, alterations, changes of service, strikes, lockouts, labor controversies, accidents, inability to obtain services, fuel, steam, water or supplies, governmental requirements or requests, or other causes beyond Landlord's reasonable control, including interference with light or other incorporeal hereditaments and any interruption in services or any failure to provide services to Landlord by a designated utility company at the demarcation point at which Landlord accepts responsibility for such service or at any point prior thereto, which interference impedes Landlord in furnishing plumbing, HVAC, electrical, sanitary, life safety, elevator, telecommunications, or other Building services, utilities, or the Systems and Equipment. None of the same shall be deemed an eviction or disturbance of Tenant's use and possession of the Premises or any part thereof, shall render Landlord liable to Tenant for abatement of Rent, or shall relieve Tenant from performance of Tenant's obligations under this Lease. Landlord in no event shall be liable for damages by reason of loss of profits, business interruption, or other compensatory or consequential damages.

8.8 SAFETY AND SECURITY DEVICES, SERVICES, AND PROGRAMS. The parties acknowledge that safety and security devices, services, and programs provided by Landlord, if any, while intended to deter crime and ensure safety, may not in given instances prevent theft or other criminal acts or ensure safety of persons or property, and such devices, services and programs shall not under any circumstances be deemed to be a guaranty, representation, or warranty by Landlord to Tenant or any third parties as to the safety or protection of person or property. The risk that any safety or security device, service, or program may not be effective, or may malfunction, or be circumvented by a criminal, is assumed by Tenant with respect to Tenant's property and interests; and Tenant shall obtain insurance coverage to the extent Tenant desires protection against such criminal acts and other losses, as further described in Article 14. Tenant agrees to cooperate in any reasonable safety or security program developed by Landlord or required by Law.

9 TENANT'S CHANGES

9.1 TENANT'S REQUESTED CHANGES. Tenant may, subject to § 9.2 below, from time to time during the Term of this Lease, at its expense, make such alterations, additions, installations, substitutions, improvements, and decorations (collectively "Tenant's Changes") in and to the Premises as Tenant may reasonably consider necessary for the conduct of its business in the Premises (except for changes which would require modification of the Property outside the Premises), on the following conditions:

- (a) the outside appearance or the strength of the Building or of any of its structural parts shall not be affected, and Tenant shall cause no penetration of the roof or the exterior fabric of the Building;
- (b) no part of the Building outside of the Premises shall be physically affected;
- (c) the proper functioning of any of the Systems and Equipment shall not be adversely affected, and the usage of such systems by Tenant shall not be increased;
- (d) no such change shall require the addition of new INC riser cable or expand the number of telephone pairs dedicated to the Premises by the Buildings' telecommunications engineering design;
- (e) in performing the work involved in making such changes, Tenant shall be bound by and observe all of the conditions and covenants contained in the following sections of this Article 9; and

(f) with respect to Tenant's Changes, Tenant shall make all arrangements for use of the freight elevators servicing the Premises.

9.2 PLANS AND APPROVAL. Before proceeding with any Tenant's Changes, Tenant shall advise Landlord thereof. All work to be performed in the Building shall be performed by the Contractor on the basis of plans and drawings prepared by the Landlord's Architect (as defined in and in the manner stated in the Work Letter Agreement). If Landlord grants permission for Tenant to utilize another architect for its Changes, before proceeding with any Tenant's Changes, Tenant shall submit to Landlord plans and specifications and all changes and revisions thereto for the work to be done for Landlord's reasonable approval; and Tenant shall, upon demand of Landlord, pay to Landlord the reasonable costs incurred and paid to third parties by Landlord for the review of such plans and specifications and all changes and revisions thereto by its architect, engineer, and other consultants. Landlord may as a condition of its approval require Tenant to make reasonable revisions in and to the plans and specifications. Landlord may require Tenant to post a bond or other security reasonably satisfactory to Landlord to insure the completion of such change. If Landlord consents to any Tenant's Changes or supervises the work of constructing any Tenant's Changes, such consent or supervision shall not be deemed a warranty as to the adequacy of the design, workmanship, or quality of materials, and Landlord hereby expressly disclaims any responsibility or liability for the same. Landlord shall under no circumstances have any obligation to repair, maintain, or replace any portion of such work. Notwithstanding anything to the contrary herein, Landlord shall not unreasonably withhold its consent to any request of Tenant at its own expense and subject to § 8.6.3 above at any time during the Term to install additional supplemental HVAC in the Premises to the same specifications as applied to the installation of Tenant's Supplemental HVAC under § 3.2(ii) above.

9.2.1 As-Built Plans. Within thirty (30) days after completion of Tenant's Changes requiring the submission of plans to Landlord, Tenant shall furnish to Landlord a complete set of "as-built" plans and specifications.

9.3 PERMITS AND PERFORMANCE. Tenant, at its expense, shall obtain all necessary governmental permits and certificates for the commencement and prosecution of Tenant's Changes and for final approval thereof upon completion and shall furnish copies thereof to Landlord. Tenant shall cause Tenant's Changes to be performed in compliance therewith and with all applicable Laws and requirements of public authorities and with all applicable requirements of insurance bodies, and in good and workmanlike manner, using new materials and equipment at least equal in quality and class to the original installations in the Premises. Tenant's Changes shall be performed in such manner as not unreasonably to interfere with, delay, or impose any additional expense upon Landlord in the renovation, maintenance, or operation of the Property or any portion thereof, unless Tenant shall indemnify Landlord therefor to the latter's reasonable satisfaction.

9.4 CONTRACTORS. All electrical, mechanical, and plumbing work in connection with Tenant's Changes shall be performed by Contractors at Tenant's expense. If Tenant shall request any electrical, mechanical, or plumbing work in connection with Tenant's Changes, Landlord shall request the Contractors to furnish Tenant with prices to perform the same prior to prosecuting same. In addition to the foregoing, and notwithstanding anything to the contrary in this Article 9, Landlord may, at Landlord's option, require that the work of constructing any Tenant's Changes be performed by the Contractor.

9.5 SUPERVISION AND FEE. Landlord may require that all work of constructing Tenant's Changes be performed under Landlord's supervision. Tenant shall pay to Landlord upon completion of any such work by the Contractor an administrative fee of five percent (5%) of the cost of the work, to cover

Landlord's overhead in reviewing Tenant's plans and specifications and performing any supervision of the work of Tenant's Changes.

9.6 RESTORATION OF FIXTURES. If any of Tenant's Changes shall involve the removal of any fixtures, equipment, or other property in the Premises which are not Tenant's Property (as defined in Article 10), such fixtures, equipment, or other property shall be promptly replaced, at Tenant's expense, with new fixtures, equipment, or other property (as the case may be) of like utility and at least equal value, unless Landlord shall otherwise expressly consent in writing; and Tenant shall, upon Landlord's request made at the time of Tenant's submittal of Tenant's plans for Tenant's Changes, store and preserve, at Tenant's sole cost and expense, any such fixtures, equipment or property so removed and shall return same to Landlord upon the expiration or sooner termination of this Lease.

9.7 MECHANIC'S LIENS. Tenant shall keep the Property and Premises free from any mechanic's, materialman's, or similar liens or other such encumbrances, including the liens of any security interest in, conditional sales of, or chattel mortgages upon, any materials, fixtures, or articles so installed in and constituting part of the Premises, in connection with any Tenant's Changes on or respecting the Premises not performed by or at the request of Landlord and shall indemnify, defend, protect, and hold Landlord harmless from and against any claims, liabilities, judgements, or costs (including reasonable attorneys' fees) arising out of the same or in connection with any such lien, security interest, conditional sale or chattel mortgage or any action or proceeding brought thereon. Tenant shall give Landlord written notice at least twenty (20) days prior to the commencement of work on any Tenant's Change in the Premises (or such additional time as may be necessary under applicable Laws), in order to afford Landlord the opportunity of posting and recording appropriate notices of nonresponsibility. Tenant shall remove any such lien or encumbrance by bond or otherwise within thirty (30) days after written notice by Landlord or at the conclusion of any contested matter not resolved in Tenant's favor; and if Tenant shall fail to do so, Landlord may pay the amount necessary to remove such lien or encumbrance, without being responsible for investigating the validity thereof. The amount so paid shall be deemed Additional Rent under this Lease payable upon demand, without limitation as to other remedies available to Landlord under this Lease. Nothing contained in this Lease shall authorize Tenant to do any act which shall subject Landlord's title to the Property or Premises to any liens or encumbrances, whether claimed by operation of law or express or implied contract. Any claim to a lien or encumbrance upon the Property or Premises arising in connection with any Work on or respecting the Premises not performed by or at the request of Landlord shall be null and void, or, at Landlord's option, shall attach only against Tenant's interest in the Premises and shall in all respects be subordinate to Landlord's title to the Property and Premises.

9.8 NOTICES OF VIOLATION. Tenant, at its expense, and with diligence and dispatch, shall procure the cancellation or discharge of all notices of violation arising from or otherwise connected with Tenant's Changes which shall be issued by any governmental, public, or quasi-public authority having or asserting jurisdiction. However, nothing herein contained shall prevent Tenant from contesting, in good faith and at its own expense, any such notice of violation, provided that Landlord's rights hereunder are in no way compromised or diminished thereby.

9.9 INDUSTRIAL RELATIONS. Tenant agrees that the exercise of its rights pursuant to the provisions of this Article 9 or any other provision of this Lease shall not be done in a manner which would create any work stoppage, picketing, labor disruption, or dispute or violate Landlord's union contracts affecting the Property and/or Complex or unreasonably interfere with the business of Landlord or any Tenant or occupant of the Building. Tenant shall, immediately upon notice from Landlord, cease any activity, whether or not permitted by this Lease, giving rise to such condition. If Tenant fails to do so, Landlord,

in addition to any rights available to it under this Lease and pursuant to Law, shall have the right to an *ex parte* injunction without notice.

10 TENANT'S PROPERTY

10.1 FIXTURES AND IMPROVEMENTS. All fixtures, equipment, improvements, alterations, and appurtenances attached to or built into the Premises at the commencement of or during the Term of this Lease, including cabinets, sinks, faucets, appliances, hot water heaters, etc. (collectively "Improvements"), whether or not by or at the expense of Tenant, shall be and remain a part of the Premises, shall be deemed the property of Landlord, and shall not be removed by Tenant, except as expressly provided in Article 11 below.

10.2 TENANT'S PROPERTY AND TRADE FIXTURES. All movable partitions, trade fixtures, office machinery and equipment, communications equipment, and computer equipment (whether or not attached to or built into the Premises) which are installed in the Premises by or for the account of Tenant, without expense to Landlord and which can be removed without structural damage to the Property, and all furniture, furnishings, and other articles of movable personal property owned by Tenant and located in the Premises (collectively "Tenant's Property") shall be and shall remain the property of Tenant and may be removed by it at any time during the Term of this Lease; provided that if any of Tenant's Property is removed, Tenant or any party or person entitled to remove same shall repair or pay the cost of repairing any damage to the Premises or to the Property resulting from such removal. Any equipment or other property for which Landlord shall have granted any allowance or credit to Tenant or which has replaced such items originally provided by Landlord at Landlord's expense shall not be deemed to have been installed by or for the account of Tenant, without expense to Landlord, and shall not be considered Tenant's Property.

11 CONDITION UPON SURRENDER

11.1 CONDITION AND RESTORATION. At or before the Expiration Date or the date of any earlier termination of this Lease, or as promptly as practicable after such an earlier termination date, Tenant, at its expense, shall do all of the following:

- (a) surrender possession of the Premises in the condition required under § 12.1 below, ordinary wear and tear and damage from casualty or condemnation excepted;
- (b) surrender all keys, any key cards, and any parking stickers or cards to Landlord and give Landlord in writing the combinations of any locks or vaults then remaining in the Premises;
- (c) remove from the Premises all of Tenant's Property, except such items thereof as Tenant shall have expressly agreed in writing with Landlord were to remain and to become the property of Landlord; and
- (d) fully repair any damage to the Premises or the Property resulting from such removal.

Tenant's obligations herein shall survive the expiration or earlier termination of the Lease, unless expressly provided to the contrary herein. All Improvements and other items in or upon the Premises (except Tenant's Property), whether installed by Tenant or Landlord, shall be Landlord's property and shall remain upon the Premises, all without compensation, setoff, allowance, or credit to Tenant;

provided, however, that if, when consent for the installation of the Improvements is requested, Landlord so directs by notice, Tenant shall promptly remove such of the Improvements in the Premises as are designated in such notice and shall restore the Premises to their condition prior to the installation of such Improvements. Notwithstanding the foregoing, Landlord shall not require removal of customary office improvements and server rooms installed pursuant to the Work Letter Agreement, if any (except as expressly provided to the contrary therein), or installed by Tenant with Landlord's written approval (except as expressly required by Landlord in connection with granting such approval).

11.2 TENANT'S FAILURE TO REMOVE OR RESTORE. If Tenant shall fail to perform any repairs or restoration or fail to remove any items from the Premises as required under this Article 11, Landlord may do so, and Tenant shall pay Landlord the cost thereof upon demand. All property removed from the Premises by Landlord pursuant to any provisions of this Lease or any Law may be handled or stored by Landlord at Tenant's expense, and Landlord shall in no event be responsible for the value, preservation, or safekeeping thereof. All property not removed from the Premises or retaken from storage by Tenant within thirty (30) days after expiration or earlier termination of this Lease or Tenant's right to possession shall at Landlord's option be conclusively deemed to have been conveyed by Tenant to Landlord as if by bill of sale without payment by Landlord. Unless prohibited by applicable Laws, Landlord shall have a lien against such property for the costs incurred in removing and storing the same.

12 REPAIRS AND MAINTENANCE

12.1 TENANT'S CARE OF PREMISES. Except for customary cleaning and trash removal provided by Landlord under § 8.1 above and damage covered under Article 15, Tenant shall keep the interior of the Premises in good and sanitary condition, working order, and repair, including carpet, wall-covering, doors pertinent to and within the Premises, plumbing, all telecommunications cables and wiring within Tenant's Premises ("IW") from the interface of such

IW with the INC, and other fixtures, equipment, alterations, and improvements, whether installed by Landlord or Tenant. In addition, Tenant, at its expense, shall promptly make all repairs, ordinary or extraordinary, interior or exterior, structural or otherwise, in and about the Premises and the Property, as shall be required by reason of (a) the performance or existence of Tenant's Work or Tenant's Changes; (b) the installation, use, or operation of Tenant's Property in the Premises; (c) the moving of Tenant's Property in or out of the Building; or (d) the misuse or neglect of Tenant or any of its employees, agents, or contractors. Tenant, at its expense, shall replace all scratched, damaged, or broken doors or other glass in or about the Premises and shall be responsible for all repairs, maintenance, and replacement of wall and floor coverings in the Premises and for the repair and maintenance of all non-Building-standard lighting fixtures therein. All repairs except for emergency repairs made by Tenant as provided herein shall be performed by Contractors. If Tenant does not promptly make such arrangements, Landlord may, but need not, make such repairs, maintenance, and replacements, and the costs paid or incurred by Landlord therefor shall be reimbursed by Tenant promptly after request by Landlord. Notwithstanding anything to the contrary herein, Tenant shall be responsible for cleaning the bottom surface of the interior roof skylight in the Premises and the top surface of the associated lantern at least once every two (2) calendars year during the Term.

12.2 LANDLORD'S CARE OF COMPLEX. Landlord, at its expense, shall keep and maintain the common areas of the Complex and the Systems and Equipment serving the Premises in good working order, condition, and repair and shall make all repairs, structural and otherwise, interior and exterior, as and when needed in or about the Complex and the Premises, except for those repairs for which Tenant is responsible pursuant to § 12.1 above or any other provisions of this Lease. Landlord shall maintain and repair all INC in the Building, and Tenant shall have no right to make repairs to INC. The cost of Landlord's maintenance and repairs pursuant to this Article 12 shall be reimbursed to Landlord to the

extent provided in Article 4 above. Landlord, at its sole cost and expense, which expense shall not be passed through to Tenant as an Operating Expense, shall repair all exterior walls of the Building to prevent wind and water infiltration no later than three (3) months after the Commencement Date. Landlord shall provide notice to Tenant when any work is being done to the electrical system of the Building that might affect the Premises.

12.3 WAIVER BY TENANT. Tenant waives the benefits of any statute now or hereafter in effect which would otherwise afford Tenant the right to make repairs at Landlord's expense or to terminate this Lease because of Landlord's failure to keep the Premises in good order, condition, and repair.

13 RULES AND REGULATIONS

13.1 OBSERVANCE AND MODIFICATION. Tenant and its employees and agents shall faithfully observe and comply with the Rules and Regulations attached hereto as **Exhibit C** (the "Rules") and such reasonable changes therein (whether by modification, elimination, or addition) as Landlord at any time or times hereafter may make and communicate in writing to Tenant, so long as such changes do not unreasonably affect the conduct of Tenant's business in the Premises, except as required by any applicable Law and are consistently applied to all occupants; provided, however, that in case of any conflict or inconsistency between the provisions of this Lease and any of the Rules as originally promulgated or as changed, the provisions of this Lease shall control.

13.2 APPLICATION TO TENANT. Nothing in this Lease shall be construed to impose upon Landlord any obligation to Tenant to enforce the Rules or the terms, covenants, or conditions in any other lease, as against any other tenant, and Landlord shall not be liable to Tenant for violation of the same by any other tenant or its employees, agents, or visitors.

14 INSURANCE AND INDEMNIFICATION

14.1 TENANT'S INSURANCE. Tenant shall obtain and maintain in effect at all times during Tenant's possession of the Premises the following insurance coverages and policies:

14.1.1 Liability Insurance. Tenant shall maintain a policy of commercial general liability insurance, which shall include coverages for (a) personal injury; (b) broad-form contractual liability; (c) owner's (*i.e.*, Tenant's) & contractor's protective; (d) automobile liability; and (e) broad-form property damage liability. The minimum limits of liability shall be a combined single limit with respect to each occurrence of not less than Two Million Dollars (\$2,000,000) and an aggregate limit of not less than Three Million Dollars (\$3,000,000). The policy shall contain a cross-liability endorsement and a severability of interest clause. Tenant shall increase the insurance coverage as reasonably required by Landlord's lender.

14.1.2 Tenant's Business Personal Property Insurance. Tenant shall maintain on all of its business personal property, including valuable business papers and accounts receivable; operating supplies; inventory; and furniture, fixtures, and equipment (whether owned, leased, or rented) (collectively "Business Personal Property") an "all risk" property damage insurance policy including coverages for earthquake damage and sprinkler leakage and containing an agreed amount endorsement (or, if applicable, a business owner's policy with a no-coinsurance provision) in an amount not less than one hundred percent (100%) of the full replacement cost valuation of such Business Personal Property. The proceeds from any such policy shall be used by Tenant for the replacement of such Business Personal property.

14.1.3 Workers' Compensation Insurance. Tenant shall maintain workers' compensation insurance as required by law and employer's liability insurance in an amount not less than Five Hundred Thousand Dollars (\$500,000).

14.1.4 Business Interruption/Extra Expense Insurance. Tenant shall maintain business interruption or (if applicable) contingent business interruption and extra expense insurance in such amounts as will reimburse Tenant for direct or indirect loss of earnings and incurred costs attributable

to the perils commonly covered by Tenant's property insurance described in § 14.1.2 above but in no event less than the average total of Tenant's annual gross receipts from the Premises during the three-year period immediately preceding such interruption or loss.

14.2 TENANT'S INSURANCE CRITERIA. All insurance required to be maintained by Tenant under this Lease shall conform to the following criteria:

- (i) Tenant's insurance shall be issued by insurance companies authorized to do business in the State of California with a financial rating of at least A:XIII for any property insurance and at least A-:IX for any liability insurance, as rated in the most recent edition of *Best's Insurance Reports*;
- (ii) Tenant's insurance shall be issued as primary and noncontributory;
- (iii) Tenant's liability and property insurance policies shall name Tenant as the insured and Landlord, Landlord's agents, and any Lessors and Holders (as such terms are defined in § 18.1 below) whose names shall have been furnished to Tenant as additional insureds;
- (iv) Tenant's insurance shall contain an endorsement requiring at least thirty (30) days' written notice from the insurance company to each insured and additional insured before cancellation or any material change in the coverage, scope, or amount of any policy; and
- (v) with respect to damage to or loss of Tenant's Business Personal Property, a waiver of subrogation must be obtained, as required under § 14.4 below.

14.2.1 Blanket Coverage. All of the insurance requirements set forth herein on the part of Tenant to be observed shall be deemed satisfied if the Premises are covered by a blanket insurance policy complying with the limits, requirements, and criteria contained in this Article 14 insuring all or most of Tenant's facilities in California.

14.2.2 Evidence of Coverage. A duplicate original policy or a certificate of insurance shall be deposited with Landlord at the commencement of the Term or, if earlier, upon Tenant's taking possession of the Premises; and on renewal of the policy a certificate of insurance listing the insurance coverages required hereunder and naming the appropriate additional insureds shall be deposited with Landlord not less than seven (7) days before expiration of the policy.

14.3 LANDLORD'S INSURANCE. Landlord shall maintain "all risk" property damage insurance containing an agreed amount endorsement covering not less than one hundred percent (100%) of the full insurable replacement cost valuation of (y) the Building and the tenant improvements, betterments, and the alterations thereto; and (z) Landlord's personal property, business papers, furniture, fixtures, and equipment (collectively "Landlord's Property"), exclusive of the costs of excavation, foundations and footings, and risks required to be covered by Tenant's insurance, and subject to commercially reasonable deductibles. Landlord shall also obtain and keep in full force the following policies of insurance: (a) commercial general liability insurance with limits at lease equal to those applicable to Tenant under

§ 14.1.1 above; (b) loss of rent insurance (also known as rent continuation insurance); (c) workers' compensation insurance, if required by applicable Law; and (d) such other insurance as Landlord deems appropriate or as may be required by any Holder or Lessor. Landlord agrees to cause Tenant to be named as an additional insured under its commercial general liability insurance policy, provided that Tenant's additional insured status shall be limited to apply only to occurrences of bodily injury and property damage caused solely by Landlord in areas of the Complex under Landlord's exclusive control (including the common areas).

14.4 RELEASES AND WAIVERS OF SUBROGATION. The purpose of this provision is to allow Landlord and Tenant to allocate and assume certain risks to coincide with insurance coverages required to be maintained pursuant to the terms to this Lease. Landlord and Tenant recognize the benefit that each will receive from the waivers of subrogation each is required to obtain pursuant to this § 14.4 and that there are significant advantages to each in connection with minimizing duplication of insurance coverages. Accordingly, Landlord and Tenant agree to accept and place the limitations which follow on each other's respective liabilities and responsibility for damages in order to coincide with required insurance coverages.

14.4.1 Tenant's Property Agreement. In light of Tenant's agreement to insure Tenant's Business Personal Property in accordance with § 14.1.2 above, Tenant agrees that Landlord will have no liability to Tenant in the event Landlord damages or destroys, negligently or otherwise, all or any part of Tenant's Business Personal Property. Tenant will cause to be placed in its insurance policies covering Tenant's Business Personal Property a waiver of subrogation so that its insurance company will not become subrogated to Tenant's rights and will not be able to proceed against Landlord in connection with any such damage or destruction.

14.4.2 Landlord's Property Agreement. In light of Landlord's agreement to insure Landlord's Property in accordance with § 14.3 above, Landlord agrees that Tenant will have no liability to Landlord in the event that Tenant damages or destroys, negligently or otherwise, all or any part of Landlord's Property. Landlord will cause to be placed in its insurance policies covering Landlord's Property a waiver of subrogation so that its insurance company will not become subrogated to Landlord's rights and will not be able to proceed against Tenant in connection with any such damage or destruction.

14.4.3 Tenant's Release. Landlord shall not be responsible or liable to Tenant for any damages or destruction to Tenant's Business Personal Property caused by Landlord's employees, agents, visitors, invitees, guests, or independent contractors (collectively "Landlord's Associates"), and Tenant hereby releases Landlord from any claims, liabilities, demands, losses, damages, consequential damages, and the like, including reasonable attorneys' fees and court costs (collectively "Claims") resulting from damage or destruction to Tenant's Business Personal Property caused directly or indirectly by Landlord and/or Landlord's Associates; provided, however, that nothing herein shall be deemed to release Landlord's independent contractors from any such Claims Tenant may have against Landlord's independent contractors.

14.4.4 Landlord's Release. Tenant shall not be responsible or liable to Landlord for any damages or destruction to Landlord's Property caused by Tenant's employees, agents, visitors, invitees, guests, or independent contractors (collectively "Tenant's Associates"), and Landlord hereby releases Tenant from any Claims resulting from damage or destruction to Landlord's Property caused directly or indirectly by Tenant and/or Tenant's Associates;

provided, however, that nothing herein shall be deemed to release Tenant's independent contractors from any such Claims Landlord may have against Tenant's independent contractors.

14.4.5 Damage to Business and Loss of Rents. In light of Landlord's agreement to carry continuation of rent insurance pursuant to § 14.3 above and Tenant's agreement to carry business interruption insurance (extra expense insurance) in accordance with § 14.1.4 above, in the event that Landlord's Property is damaged or destroyed because of any act or conduct, negligent or otherwise, by Tenant and/or by Tenant's Associates, Landlord shall have no rights against Tenant by virtue of such damage or destruction, and Landlord hereby releases Tenant from all Claims, including claims for loss of rent or profits, by Landlord directly or indirectly resulting from the damage or destruction of Landlord's Property by conduct by Tenant and/or by Tenant's Associates. Likewise, in the event that Tenant's Business Personal Property is damaged or destroyed because of any act or conduct, negligent or otherwise, by Landlord and/or by Landlord's Associates, Tenant shall have no rights against Landlord by virtue of such damage or destruction, and Tenant hereby releases Landlord from all Claims by Tenant directly or indirectly resulting from the damage or destruction to Tenant's Business Personal Property by the conduct of Landlord and/or Landlord's Associates, including Claims for loss of business or loss of profits. Notwithstanding the foregoing, nothing herein shall be deemed to release Tenant's or Landlord's independent contractors from any liability to Tenant and/or Landlord.

14.4.6 Injury and Death to Individuals. Landlord and Tenant understand that waivers of subrogation do not apply to injury to and death of individuals. Landlord and Tenant shall each carry insurance, as provided by this Article 14, in connection with injury and death to individuals. Landlord hereby agrees to indemnify and hold Tenant harmless from any Claims which Tenant may otherwise have with respect to injury or death to individuals occurring within the Property but outside the Premises, except to the extent that such injury or death is caused by Tenant and/or Tenant's Associates, through negligence or otherwise, and is not covered by the insurance Landlord is required to carry under this Lease. Likewise, Tenant agrees to indemnify, defend, protect, and hold Landlord harmless from any Claims for injury or death to persons occurring within the Premises or caused, directly or indirectly, by Tenant or Tenant's Associates outside the Premises, except to the extent such injuries or death are caused by Landlord and/or Landlord's Associates, through negligence or otherwise, and are not covered by the insurance Tenant is required to carry under this Lease.

14.4.7 Abatement of Rent. Except as may be expressly provided elsewhere in this Lease, Tenant shall not be entitled to Rent abatement and shall not otherwise have, and hereby releases Landlord from, any Claims resulting from Tenant's inability to utilize all or any part of the Premises, except to the extent that Tenant is unable to use all or any part of the Premises and does not use all or any part of the Premises as a result of Landlord's intentional decision to refuse to provide access to the Building and/or the Premises and/or to provide services and/or utilities to Tenant as required to be provided by Landlord to Tenant pursuant to this Lease, where such refusal is not caused by a Force Majeure occurrence.

14.4.8 Availability of Waiver of Subrogation. If an insurance policy cannot be obtained with a waiver of subrogation or is obtainable only by the payment of an additional premium charge above that charged by insurance companies issuing policies without waiver of subrogation, the party undertaking to obtain the insurance shall notify the other party of this fact. The other party shall have a period of ten (10) days after receiving the notice either to place the insurance with a company that is reasonably satisfactory to the other party and that will carry the insurance with a waiver of subrogation at no additional cost or to agree to pay the additional premium if such a policy is obtainable at additional cost. If the insurance cannot be obtained or the party in whose favor a waiver of subrogation is desired refuses to pay the additional premium charged, the other party is relieved of the obligation to obtain a waiver of subrogation with respect to the particular insurance involved.

14.5 OTHER CASES OF DAMAGE OR INJURY. In all cases not covered by the foregoing provisions of this Article 14, Tenant hereby assumes all risk of damage to property or injury to persons in, upon, or about the Premises from any cause other than the negligence or intentional misconduct of Landlord and its agent or employees. Without limiting the generality of the foregoing, Landlord shall not be liable for injury or damage which may be sustained by the person, goods, wares, merchandise, or property of Tenant or Tenant's Associates or any other person in or about the Premises caused by or resulting from fire, steam, electricity, gas, water or rain, which may leak or flow from or into any part of the Premises, or from the breakage, leakage, obstruction, or other defects of the Systems and Equipment, pipes, sprinklers, wires, INC, appliances, plumbing, heating, air-conditioning, or lighting fixtures of the same, whether the damage or injury results from conditions arising upon the Premises or upon other portions of the Property, the Complex, or from other sources. Landlord shall not be liable for any damages arising from any act or omission of any other tenant or occupant of the Property or Complex. In all cases not covered by the foregoing provisions of this Article 14, Tenant shall indemnify, defend, protect, and hold Landlord harmless against (a) any and all Claims arising from any death or injury to any person or damage to any property whatsoever occurring in, on, or about the Premises or any part thereof, and (b) any and all Claims occurring in, on or about any of the Common Areas, the Property, or the Complex, when such death, injury or damage is caused in whole or in part by the act, negligence, fault, or omission of any duty with respect to the same by Tenant or Tenant's Associates. In all cases not covered by the foregoing provisions of this Article 14, Tenant shall further indemnify, defend, protect, and hold Landlord harmless from and against any and all Claims arising from any breach or default in the performance of any obligation on Tenant's part to be performed under this Lease, or arising from any act or negligence of Tenant or Tenant's Associates, and from and against all reasonable costs, attorneys' fees, expenses, and liabilities incurred in connection with any such Claim or any action or proceeding brought thereon. In case any action or proceeding be brought against Landlord by reason of any such Claim, Tenant, upon notice from Landlord, shall defend the same at Tenant's expense by counsel reasonably satisfactory to Landlord; provided, however, that Tenant shall not be liable in any case for damage to property or death or injury to person(s) occasioned by the negligence or intentional misconduct of Landlord or Landlord's Associates, unless covered by insurance Tenant is required to provide.

15 DAMAGE OR DESTRUCTION

15.1 LOSSES. If at any time prior to the expiration or termination of this Lease the Premises or the Property is wholly or partially damaged or destroyed by any casualty which renders the Premises totally or partially inaccessible or unusable by Tenant in the ordinary conduct of Tenant's business, the parties agree that the following provisions shall modify their obligations under this Lease after such damage or destruction.

15.1.1 Repairs Which Can Be Completed Within Six (6) Months. Within thirty (30) days after Tenant's written notice to Landlord of such damage or destruction, Landlord shall provide Tenant with notice of its determination of whether the damage or destruction can be repaired within six (6) months after the commencement of the work of repairing such damage or destruction without the payment of overtime or other premiums. If all repairs to Premises or Property can, in Landlord's reasonable judgement, be completed within six (6) months following the date of the commencement of the work of repairing such damage or destruction without the payment of overtime or other premiums, Landlord shall, at Landlord's expense, expeditiously repair the same; and this Lease shall remain in full force and effect, except that a proportionate reduction of the Base Rent shall be allowed Tenant to the extent that the Premises shall be rendered inaccessible or unusable by Tenant and are not used by Tenant during the period of time that such portion is unusable or inaccessible and not used by Tenant.

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15.1.2 Repairs Which Cannot Be Completed Within Six (6) Months. If all such repairs to the Property and Premises cannot, in Landlord's reasonable judgement, be completed within six (6) months following the commencement of the work of repairing such damage or destruction without the payment of overtime or other premiums, Landlord shall notify Tenant of such determination; and in such an event, either Landlord or Tenant may, at its option, upon written notice to the other party given within sixty (60) days after the occurrence of such damage or destruction, elect to terminate this Lease as of the date of the occurrence of such damage or destruction. In the event that neither Landlord nor Tenant elects to terminate the Lease in accordance with the foregoing provisions, then Landlord shall, at Landlord's expense, repair such damage or destruction; and in such event, this Lease shall continue in full force and effect, except that the Base Rent shall be proportionately reduced as provided in § 15.1.1 above; provided, however, that if any such repair is not commenced by Landlord within ninety (90) days after the occurrence of such damage or destruction or is not substantially completed by Landlord within nine (9) months after the occurrence of such damage or destruction, then in either such event Tenant may, at its option, upon written notice to Landlord, elect to terminate this Lease as of the date of Landlord's receipt of such notice. Notwithstanding the foregoing, Tenant shall have no right to terminate this Lease in the situation just described if all of the following conditions are met: (x) Landlord shall have informed Tenant in its notice of determination that the repair of such damage or destruction could not be substantially completed by Landlord within nine (9) months after the occurrence of such damage or destruction; (y) Tenant shall not have elected to terminate the Lease by written notice delivered to Landlord within sixty (60) days after the occurrence of such damage or destruction; and (z) Landlord shall have commenced the work of repairing such damage or destruction and diligently prosecuted the same thereafter.

15.2 DESTRUCTION DURING FINAL YEAR. Notwithstanding anything to the contrary contained in § 15.1, if the Premises or the Building are wholly or materially damaged or destroyed within the final twelve (12) months of the Term of this Lease or, if an applicable renewal option has been exercised, during the last year of any renewal term, in such a way that Tenant shall be prevented from using the Premises for at least thirty (30) consecutive days as a result of such damage or destruction, then either Landlord or Tenant may, at the option of either, by written notice to the other party delivered within sixty (60) days after the occurrence of such damage or destruction, elect to terminate the Lease as of the date of such notice.

15.3 DESTRUCTION OF TENANT'S PROPERTY. Under no circumstances shall Landlord be required to repair any injury or damage to, or make any repairs to or replacements of, Tenant's Property. However, as part of Operating Expenses, Landlord shall cause to be insured the Improvements in the Premises which do not consist of Tenant's Property and shall cause such Improvements to be repaired and restored at Landlord's sole expense, except that Tenant shall pay any applicable deductible. Landlord shall have no responsibility for any contents placed or kept in or on the Premises or the Property by Tenant or Tenant's employees or invitees or any other person claiming through Tenant.

15.4 EXCLUSIVE REMEDY. Landlord and Tenant agree that their respective rights and obligations in the event of any damage or destruction of the Premises, Property, or Complex shall be governed exclusively by this Lease. Tenant, as a material inducement to Landlord entering into this Lease, irrevocably waives and releases Tenant's rights under California Civil Code §§ 1932(2), 1933(4), and 1942, as the same may be modified or replaced hereafter. No damages, compensation, setoff, allowance, or claim shall be payable by Landlord for any inconvenience, interruption, or cessation of Tenant's business or any annoyance arising from any damage to or destruction of all or any portion of the Premises, Property, or Complex.

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16 EMINENT DOMAIN

16.1 CONDEMNATION. If the whole or any material part of the Premises or Property shall be taken by power of eminent domain or condemned by any competent authority for any public or quasi-public use or purpose; or if any adjacent property or street shall be so taken, condemned, reconfigured, or vacated by such authority in such manner as to require the use, reconstruction, or remodeling of any part of the Premises or Property; or if Landlord shall grant a deed or other instrument in lieu of such taking by eminent domain or condemnation (collectively "Takings"), either party shall have the option to terminate this Lease upon ninety (90) days' notice, provided such notice is given no later than one hundred and eighty (180) days after the date of such Taking. Tenant shall have reciprocal termination rights, on the same terms and conditions and to be exercised in the same manner as the foregoing sentence provides, if the whole or any material part of the Premises is permanently taken, or if access to the Premises is permanently materially impaired.

16.2 RENTAL APPORTIONMENT. All Rent shall be apportioned as of the date of such termination or the date of such Taking, whichever shall first occur. If any part of the Premises shall be taken, and this Lease shall not be so terminated, the Rent shall be proportionately abated.

16.3 AWARDS AND DAMAGES. Landlord shall be entitled to receive the entire award or payment in connection with any Taking, except that Tenant shall have the right to file any separate claim available to Tenant for any taking of Tenant's personal property and fixtures belonging to Tenant and removable by Tenant upon expiration of the Term, and for moving expenses, so long as such claim does not diminish the award available to Landlord and such claim is payable separately to Tenant.

16.4 TEMPORARY CONDEMNATION. If part or all of the Premises are condemned for a limited period of time ("Temporary Condemnation"), this Lease shall remain in effect. The Rent and Tenant's obligations for the part of the Premises taken shall abate during the Temporary Condemnation in proportion to the part of the Premises that Tenant is unable to use in its business operations as a result of the Temporary Condemnation. Landlord shall receive the entire award for any Temporary Condemnation.

17.1 CONSENT REQUIRED FOR TRANSFER. Except as otherwise provided herein, Tenant agrees that it shall not assign, sublet, mortgage, hypothecate, or encumber this Lease, nor permit or allow the Premises or any part thereof to be used or occupied by others, without the prior written consent of Landlord in each instance, which consent shall not be unreasonably withheld, conditioned, or delayed in accordance with the criteria herein established. The actions described in the foregoing sentence are referred to collectively herein as “Transfers” and individually as a “Transfer.” If the Premises or any part thereof be sublet or occupied by anybody other than Tenant, Landlord may, after default by Tenant, collect rent from the subtenant or occupant and apply the net amount collected to the Rent herein reserved; but no Transfer, occupancy, or collection shall be deemed a waiver of the provisions hereof, the acceptance of the subtenant or occupant as tenant, or a release of Tenant from the further performance hereunder by Tenant. The consent by Landlord to a Transfer shall not relieve Tenant from obtaining the Landlord’s express written consent to any further Transfer. In no event shall any permitted sublessee assign or encumber its sublease or further sublet all or any portion of its sublet space, or otherwise suffer or permit the sublet space or any part thereof to be used or occupied by others, without Landlord’s prior written consent in each instance.

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17.1.1 Corporate Transferor. If Tenant is a corporation, the provisions of § 17.1 shall apply to a transfer (by one or more transfers) of a majority of the stock of Tenant as if such transfer of a majority of the stock of Tenant were an assignment of this Lease.

17.2 NOTICE OF INTENT TO TRANSFER. If Tenant shall at any time or times during the Term of this Lease desire to assign this Lease or sublet all or part of the Premises, Tenant shall give notice thereof (the “Transfer Notice”) to Landlord, which notice shall set forth all of the following:

- (a) the proposed terms of the assignment or subletting, including (i) the effective or commencement date thereof, which shall be not less than thirty (30) nor more than one hundred eighty (180) days after the giving of such notice; (ii) in the case of a proposed assignment, the consideration therefor; and (iii) in the case of a proposed subletting, the rental rate to be paid by the proposed subtenant (including any escalation or Additional Rent payable), the term of the proposed sublease (including any renewal options), any work to be performed or paid for by Tenant, the amount of any security deposit, the cost and extent of any so-called “take-over” obligations to be assumed by Tenant on behalf of such subtenant, the amount of any rent concessions to be granted by Tenant, and any other additional monetary or so-called “business” terms or conditions;
- (b) a statement setting forth in reasonable detail the identity of the proposed assignee or subtenant, the nature of its business, and its proposed use of the Premises; and
- (c) current financial information with respect to the proposed assignee or subtenant, including its most recent financial report, and any other information which may reasonably be required by Landlord.

17.3 CONDITIONS OF CONSENT. Providing that Tenant is not in default of any of Tenant’s material obligations under this Lease after notice and the expiration of any applicable grace period, Landlord’s consent (which must be in writing and in form reasonably satisfactory to Landlord) to the proposed assignment or sublease shall not be unreasonably withheld or delayed, provided the following conditions are met:

- (a) Tenant shall have complied with the provisions of § 17.2 above;
- (b) In Landlord’s reasonable judgement the proposed assignee or subtenant is engaged in a business which would use the Premises, or the relevant part thereof, in a manner which is in keeping with the then-current standards of the Building, is limited to the use expressly permitted under this Lease, and will not violate any negative covenant or other restriction or agreement as to use contained in any other lease of space in the Complex;
- (c) The proposed assignee or subtenant has not been convicted of fraud or illegality and has reasonably sufficient financial worth considering the responsibility involved (and in no event of less financial standing than Tenant, if the proposed Transfer is for the entirety of the Premises), is not subject to any toxic or hazardous materials cleanup order with respect to any other property, and Landlord has been furnished with reasonable proof thereof;
- (d) Neither the proposed assignee or sublessee nor any person which, directly or indirectly, controls, is controlled by, or is under common control with, the proposed

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assignee or sublessee or any person who controls the proposed assignee or sublessee, is then an occupant of any part of the Complex, provided Landlord then has suitable space in the Complex available for leasing. For purposes of this Lease *control* shall be deemed to mean ownership of more than fifty percent (50%) of all the voting stock of a corporation or more than fifty percent (50%) of all the legal and equitable interest in any other business entity;

- (e) The proposed assignee or sublessee is not a person or entity with whom Landlord is then negotiating to lease space in the Building;
- (f) The form of the proposed lease shall be in form reasonably satisfactory to Landlord and shall comply with the applicable provisions of this Article 17;
- (g) There shall not be more than three (3) subtenants (not including the Permitted Occupant (as defined in § 17.13 below) of the Premises);

- (h) Tenant shall reimburse Landlord on demand for any reasonable costs that may be incurred or paid by Landlord to third persons in connection with said assignment or sublease, including costs of making investigations as to the acceptability of the proposed assignee or subtenant and legal costs incurred in connection with the granting of any requested consent; and
- (i) Tenant shall not have advertised or publicized in any way the availability of the Premises without prior notice to and approval by Landlord, nor shall any advertisement state the name (as distinguished from the address) of the Complex or the rental rate;
- (j) The sublease shall not allow the use of the Premises or any part thereof for (i) the sale of food for on or off-premises consumption or (ii) use by a foreign or domestic governmental agency.

17.4 CONTINUATION OF LEASE TERMS. Each subletting pursuant to this Article 17 shall be subject to all of the covenants, agreements, terms, provisions, and conditions contained in this Lease. Notwithstanding any such subletting to any other subtenant and/or acceptance of Rent by Landlord from any subtenant, Tenant shall remain liable for the payment of the Base Rent and Additional Rent due and to become due hereunder and for the performance of all the covenants, agreements, terms, provisions, and conditions contained in this Lease on the part of Tenant to be performed and all acts and omissions of any licensee or subtenant or anyone claiming under or through any subtenant which shall be in violation of any of the obligations of this Lease; and any such violation shall be deemed to be a violation by Tenant. Tenant further agrees that notwithstanding any such subletting, no other and further subletting of the Premises by Tenant or any person or entity claiming through or under Tenant shall or will be made except upon compliance with and subject to the provisions of this Article 17.

17.5 LAPSE OF CONSENT. In the event that Landlord consents to a proposed Transfer described in the Transfer Notice and Tenant fails to execute and deliver the assignment or sublease described in the Transfer Notice to which Landlord consented within one hundred twenty (120) days after the giving of such consent, then Tenant shall again comply with all of the provisions and conditions of § 17.2 above before assigning this Lease or subletting all or part of the Premises.

17.6 TRANSFER DOCUMENTATION. With respect to each and every Transfer authorized by Landlord under the provisions of this Lease, it is further agreed as follows:

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- (a) no subletting shall be for a term ending later than one day prior to the Expiration Date of this Lease;
 - (b) no sublease shall be valid, and no subtenant shall take possession of the Premises or any part thereof, until an executed counterpart of such sublease has been delivered to Landlord;
 - (c) each sublease shall provide that it is subject and subordinate to this Lease and to the matters to which this Lease is or shall be subordinate, and that in the event of termination (whether by voluntary surrender or otherwise), re-entry, or dispossession by Landlord under this Lease, Landlord may, at its option, take over all of the right, title, and interest of Tenant, as sublessor, under such sublease, and such subtenant shall, at Landlord's option, attorn to Landlord pursuant to the then-executory provisions of such sublease, except that Landlord shall not be (i) liable for any previous act or omission of Tenant under such sublease; (ii) subject to any offset, credit, or allowance not expressly provided in such sublease which theretofore accrued to such subtenant against Tenant or (iii) bound by any previous modification of such sublease or by any previous prepayment of more than one month's rentals; and
 - (d) each assignment or sublease document must provide that the assignee or subtenant expressly assumes all obligations of the Tenant under the Lease as joint and several obligations without any release of Tenant.

17.7 TRANSFER PREMIUM. If Landlord shall give its consent to any assignment of this Lease or to any sublease, Tenant shall in consideration therefor pay to Landlord, as Additional Rent, the following amounts (collectively the "Transfer Premium"):

- (a) in the case of an assignment, an amount equal to fifty percent (50%) of all sums and other considerations paid to Tenant by the assignee for or by reason of such assignment, including sums paid for the sale of Tenant's Property, but excluding the following: (i) in the case of a sale of Tenant's Property, the then-current net unamortized or undepreciated cost thereof determined on the basis of Tenant's federal income tax returns; (ii) then-customary brokerage commissions being paid by Landlord for leasing of space in the Building or, if less, the brokerage commission paid by Tenant in connection with the assignment; (iii) reasonable legal fees and disbursements; and (iv) reasonable amounts paid by Tenant for tenant improvements constructed for the assignee; and
- (b) in the case of a sublease, fifty percent (50%) of any rents, additional charge, or other consideration payable under the sublease to Tenant by the subtenant which is in excess of the Base Rent and Additional Rent accruing during the term of the sublease in respect of the subleased space (at the rate per square foot payable by Tenant hereunder) pursuant to the terms hereof, including sums paid for the sale or rental of Tenant's Property, but excluding the following: (i) in the case of the sale or lease of Tenant's Property, the then-current net unamortized or undepreciated cost thereof determined on the basis of Tenant's federal income tax returns; (ii) then-customary brokerage commissions being paid by Landlord for leasing of space in the Building or, if less, the brokerage commission paid by Tenant in connection with the sublease; (iii) reasonable legal fees and disbursements; and

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- (iv) reasonable amounts paid by Tenant for tenant improvements constructed for the subtenant.

The sums payable as the Transfer Premium under this § 17.7 shall be paid to Landlord as and when payable by the subtenant or assignee to Tenant.

17.8 ASSUMPTION BY TRANSFEREE. Any Transfer, whether made with Landlord's consent pursuant to § 17.1 or without Landlord's consent pursuant to § 17.1.1, shall be made only if, and shall not be effective until, the assignee or subtenant shall execute, acknowledge, and deliver to Landlord an agreement in form and substance satisfactory to Landlord under which the assignee or transferee shall assume the obligations of this Lease on the part of Tenant to be performed or observed, from and after the date of Transfer, and whereby the assignee or transferee shall agree that the provisions in § 17.1 shall, notwithstanding such Transfer, continue to be binding upon it in respect of all future Transfers. The original named Tenant covenants that, notwithstanding any Transfer, whether or not in violation of the provisions of this Lease, and notwithstanding the acceptance of Base Rent and/or Additional Rent by Landlord from an assignee, transferee, or any other party, the original named Tenant shall remain fully liable for the payment of the Base Rent and Additional Rent and for the other obligations of this Lease on the part of Tenant to be performed or observed.

17.9 WAIVER OR DISCHARGE. The parties agree that it shall be reasonable for Landlord to refuse its consent to any proposed Transfer in connection with which Tenant also seeks a release.

17.10 LISTING OF NAME. The listing of any name other than that of Tenant, whether on the doors of the Premises or the Building directory, or otherwise, shall not operate to vest any right or interest in this Lease or in the Premises, nor shall it be deemed to be the consent of Landlord to any Transfer of this Lease or to any sublease of the Premises or to the use or occupancy of the Premises by others.

17.11 NET PROFITS AGREEMENT. Anything contained in the foregoing provisions of this Article 17 to the contrary notwithstanding, neither Tenant nor any other person or entity having an interest in the possession, use, occupancy, or utilization of the Premises shall enter into any lease, sublease, license, concession, or other agreement for use, occupancy, or utilization of space in the Premises which provides for rental or other payment for such use, occupancy, or utilization based, in whole or in part, on the net income or profits derived by any person from the premises leased, used, occupied, or utilized (other than an amount based on a fixed percentage or percentages of receipts or sales); and any such purported lease, sublease, license, concession, or other agreement shall be absolutely void and ineffective as a conveyance of any right or interest in the possession, use, occupancy, or utilization of any part of the Premises.

17.12 AFFILIATES. Notwithstanding anything to the contrary in this Article 17, Landlord's consent shall not be required in the event Tenant desires to assign this Lease or sublet the Premises or any portion thereof to any corporation or entity which controls, is controlled by, or is under common control with Tenant, provided and subject to the following conditions:

- (a) Tenant shall not be in default of any of the material terms, covenants, or conditions on Tenant's part to observe or perform hereunder beyond all applicable notice and cure periods;
- (b) such sublet or assignment shall be subject to all of the terms, covenants, and conditions of this Lease;

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- (c) Tenant shall notify Landlord of such sublet or assignment in accordance with § 17.2 hereof and furnish Landlord with reasonably satisfactory evidence that such sublessee or assignee controls, is controlled by, or is under common control with Tenant; and
 - (d) in the event of such merger, consolidation, or transfer of substantially all of Tenant's assets, the successor to Tenant has a net worth, computed in accordance with generally-accepted accounting principles, at least equal to the greater of (i) the net worth of Tenant immediately prior to such merger, consolidation, or transfer or (ii) the net worth of Tenant herein named on the date of this Lease; and proof satisfactory to Landlord of such net worth shall have been delivered to Landlord at least ten (10) days prior to the effective date of any such transaction.

As used herein, the terms *control* and *common control* shall be deemed to mean that the ownership of fifty percent (50%) or more of all of the issued and outstanding voting shares of such corporation, or fifty percent (50%) or more of all the legal and equitable interest in any such business entities.

17.13 PERMITTED OCCUPANTS. Landlord hereby agrees that the provisions of this Article 17 shall not apply to the shared occupancy of individual offices in the Premises with Tenant by individuals renting not more than one (1) such office (the "Permitted Occupant"), provided that the space occupied by the Permitted Occupant shall not be separately demised or contain separate entrances, demarcations, or reception areas and the occupancy by the Permitted Occupant shall be upon and subject to all of the terms and conditions of this Lease.

18 SUBORDINATION AND ATTORNMENT

18.1 SUBORDINATION OF LEASE. This Lease and all rights of Tenant hereunder are and shall be subject and subordinate in all respects to (a) all ground leases, overriding leases, and underlying leases of the Building, Property, and/or the Complex now or hereafter existing; (b) all mortgages which may now or hereafter affect the Building, Property, or Complex and any of such leases, whether or not such mortgages shall also cover other lands and/or buildings; (c) each and every advance made or hereafter to be made under such mortgages; and (d) to all renewals, modifications, replacements, and extensions of such leases and such mortgages and spreaders and consolidations of such mortgages. This § 18.1 shall be self-operative, and no further instrument of subordination shall be required. In confirmation of such subordination, Tenant shall promptly execute and deliver any instrument that Landlord, the lessor of any such lease or the holder ("Holder") of any such mortgage or any of their respective successors in interest may reasonably request to evidence such subordination, so long as such instrument provides that Tenant's use and occupancy of the Premises shall not be disturbed in the absence of a material default. The leases to which this Lease is, at the time referred to, subject and subordinate pursuant to this Article 18 are hereinafter sometimes referred to as "Superior Leases"; the mortgages to which this Lease is, at the time referred to, subject and subordinate are hereinafter sometimes referred to as "Superior Mortgages"; and the lessor of a superior lease or its successor in interest at the time referred to is sometimes hereinafter referred to as a "Lessor." Notwithstanding the foregoing, Tenant agrees, upon written request from Landlord or any Holder or Lessor, to reorder the relative priority of the Lease with respect to any particular Superior Mortgage or Superior Lease so as to subordinate the lien of any such Superior Mortgage or Superior Lease to the Lease. Tenant agrees to execute any instrument which Landlord or any Holder or Lessor may present in order to effect such prioritization of the Lease, provided that such instrument does not modify any material term of the Lease or increase Tenant's obligations thereunder.

18.1.1 Nondisturbance Agreement. Landlord agrees that it will use reasonable efforts to obtain a nondisturbance agreement for the benefit of Tenant from the Holder(s) of any Superior Lease(s) or Superior Mortgage(s) now existing or hereafter created during the Term of this Lease. Such nondisturbance agreement shall provide, in effect, that so long as there exists no Event of Default, and provided Tenant attorns as herein specified, the following terms shall govern such attornment, subject to the terms of § 18.3 below:

- (a) Tenant's rights as set forth in the Lease shall not be affected or terminated;
- (b) Tenant's possession of the Premises shall not be disturbed;
- (c) no action or proceeding shall be commenced to remove or evict Tenant solely by virtue of such Successor Landlord's succession to the rights of Landlord under the Lease;
- (d) this Lease shall at all times continue in full force and effect notwithstanding the foreclosure of the Superior Mortgage prior to the expiration or termination of this Lease;
- (e) Tenant shall pay Rent to said Holder or Lessor from the date of said attornment; and
- (f) such Holder or Lessor shall not be responsible to Tenant under this Lease, except as to obligations accruing subsequent to the date of such attornment.

The inability of Landlord to obtain such a nondisturbance agreement as referred to in the preceding sentence shall not be deemed a default on Landlord's part of its obligations under the Lease or affect the validity thereof or create any claim in favor of Tenant against Landlord by reason thereof.

18.2 NOTICE AND CURE RIGHT. In the event of any action or omission of Landlord which would give Tenant the right, immediately or after lapse of a period of time, to cancel or terminate this Lease, or to claim a partial or total eviction, Tenant shall not exercise such right unless and until (i) Tenant shall have given written notice of such act or omission to the Holder of each Superior Mortgage and the Lessor of each Superior Lease whose name and address shall previously have been furnished to Tenant in writing; and (ii) unless such act or omission shall be one which is not capable of being remedied by Landlord or such mortgage Holder or Lessor within a reasonable period of time, a reasonable period for remedying such act or omission shall have elapsed following the giving of such notice and following the time when such Holder or Lessor shall have become entitled under such Superior Mortgage or Superior Lease, as the case may be, to remedy the same (which reasonable period shall in no event be less than the period to which Landlord would be entitled under this Lease or otherwise, after similar notice, to effect such remedy), provided such Holder or Lessor shall with due diligence give Tenant written notice of intention to remedy such act or omission and shall thereafter diligently and continuously prosecute such cure to completion.

18.3 ATTORNMENT. If the Lessor of a Superior Lease or the Holder of a Superior Mortgage shall succeed to the rights of Landlord under this Lease, whether through possession or foreclosure action or delivery of a new lease or deed, then at the request of such party so succeeding to Landlord's rights or other person having or acquiring title by virtue of such foreclosure or termination (herein sometimes referred to as "Successor Landlord") and upon such Successor Landlord's written agreement to accept Tenant's attornment, Tenant shall attorn to and recognize such Successor Landlord as Tenant's landlord under this Lease and shall promptly execute and deliver any instrument that such Successor Landlord may reasonably request to evidence such attornment, so long as such instrument provides for nondisturbance

of Tenant's use and occupancy of the Premises in the absence of material default. Upon such attornment this Lease shall continue in full force and effect as a direct lease between the Successor Landlord and Tenant upon all of the terms, conditions, and covenants in this Lease, except as follows:

- (a) the Successor Landlord shall not be liable for any previous act or omission of Landlord under this Lease;
- (b) the Successor Landlord shall not be subject to any offset (unless expressly provided for in this Lease) which shall have theretofore accrued to Tenant against Landlord;
- (c) the Successor Landlord shall not be bound by any previous modification of this Lease, unless expressly provided for in this Lease, or by any previous prepayment of more than one month's Base Rent, unless such modification or prepayment shall have been expressly approved in writing by the Lessor of the Superior Lease or the Holder of the Superior Mortgage through or by reason of which the Successor Landlord shall have succeeded to the rights of Landlord under this Lease.

19 FINANCING REQUIREMENTS

19.1 LENDER-REQUESTED MODIFICATIONS. If, in connection with obtaining financing or refinancing for the Property or Complex a prospective lender shall request reasonable modifications to this Lease as a condition to such financing or refinancing, Tenant shall not withhold, delay, or unreasonably condition its consent thereto, so long as such modifications do not materially increase Tenant's obligations under the Lease or materially adversely affect any of Tenant's rights. It is agreed that, among the modifications which shall be deemed reasonable, are modifications to the subordination and attornment provisions of this Lease, modifications to the notice provisions of this Lease, modifications to the provisions of this Lease which permit the lender to cure any defaults by Landlord, and modifications to the provisions which grant additional time to cure as may be reasonably required by the lender.

20.1 TENANT'S DEFAULT. Tenant's failure to perform any of its obligations under this Lease when due and in the manner required shall constitute a breach and default ("Event of Default") of this Lease by Tenant, subject to any cure period(s) permitted or available under applicable laws or statutes. In addition, the following shall also be deemed Events of Default hereunder:

- (a) Tenant's failure to pay any Rent or any other charges required to be paid by Tenant under this Lease, where such failure continues for five (5) days after notice from Landlord that such payment is overdue and payable, provided that Landlord shall not be required to give any such notice more often than one (1) time during each calendar year of the Term;
- (b) Tenant's failure promptly and fully to perform any other covenant, condition, or agreement contained in this Lease, where such failure continues for thirty (30) days after written notice thereof from Landlord to Tenant;
- (c) Tenant's failure to take possession of the Premises for a period of sixty (60) days or longer after the Commencement Date;
- (d) Tenant's abandonment of the Premises;

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- (e) any material misrepresentation or omission herein or in any financial statements or other materials provided by Tenant or any Guarantor in connection with negotiating or entering this Lease or in connection with any Transfer under Article 17;
 - (f) failure by Tenant to cure within any applicable times permitted thereunder any default under any other lease for space in the Complex or any other buildings owned or managed by Landlord or its affiliates now or hereafter entered by Tenant; and any Default hereunder not cured within the times permitted for cure herein shall, at Landlord's election, constitute a default under any other such lease or leases;
 - (g) The levy of a writ of attachment or execution on this Lease or on any of Tenant's property;
 - (h) Tenant's or any Guarantor's general assignment for the benefit of creditors or arrangement, composition, extension, or adjustment with its creditors;
 - (i) Tenant's or any Guarantor's filing of a voluntary petition for relief, or the filing of a petition against Tenant or any Guarantor in a proceeding under the Federal Bankruptcy laws or other insolvency laws which is not withdrawn or dismissed within forty-five (45) days thereafter; or, under the provisions of any law providing for reorganization or winding up of corporations, the assumption by any court of competent jurisdiction of jurisdiction, custody, or control of Tenant or any substantial part of its property, or of any Guarantor, where such jurisdiction, custody, or control remains in force unrelinquished, unstayed, or unterminated for a period of forty five (45) days;
 - (j) In any proceeding or action in which Tenant is a party, the appointment of a trustee, receiver, agent, or custodian to take charge of the Premises or Tenant's Property for the purpose of enforcing a lien against the Premises or Tenant's Property; or
 - (k) If Tenant or any Guarantor is a partnership or consists of more than one (1) person or entity, the involvement of any partner of the partnership or other person or entity in any of the acts or events described in subsections (i) through (l) above.

20.2 LANDLORD'S REMEDIES. Upon the occurrence of an Event of Default hereunder, Landlord shall have the right, in addition to any other rights or remedies Landlord may have under Laws, at Landlord's option, without further notice or demand of any kind, to elect to do one of the following alternatives:

- (i) Terminate this Lease and Tenant's right to possession of the Premises, re-enter the Premises upon receipt of a judgement for possession, and take possession thereof; and Tenant shall have no further claim to the Premises or under this Lease; or
- (ii) Continue this Lease in effect and collect any unpaid Rent or other charges which have theretofore accrued or which thereafter become due and payable. It is intended hereunder that Landlord have the remedy described in California Civil Code § 1951.4, which provides that a landlord may continue a lease in effect after a tenant's breach and abandonment and recover rent as it becomes due, if tenant has the right to sublease or assign, subject only to reasonable limitations.

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In the event of any re-entry or retaking of possession by Landlord, Landlord shall have the right, but not the obligation, to remove all or any part of Tenant's Property from the Premises and to place such property in storage at a public warehouse at the expense and risk of Tenant.

20.2.1 No Waiver of Default. The waiver by Landlord of any Event of Default or of any other breach of any term, covenant, or condition of this Lease shall not be deemed a waiver of such term, covenant, or condition or of any subsequent breach of the same or any other term, covenant, or condition. Acceptance of Rent by Landlord subsequent to any Event of Default or breach hereof shall not be deemed a waiver of any preceding Event of Default or breach other than the failure to pay the particular Rent so accepted, regardless of Landlord's knowledge of any breach at the time of such acceptance of Rent. Landlord shall not be deemed to have waived any term, covenant, or condition of this Lease, unless Landlord gives Tenant written notice of such waiver. Tenant should not rely upon Landlord's failure or delay in enforcing any right or remedy hereunder.

20.2.2 Landlord's Right to Cure. If Tenant defaults in the performance of any of its obligations under this Lease, Landlord may (but shall not be obligated to), without waiving such default, after the expiration of all applicable notice and cure periods, perform the same for the account and at the expense of Tenant. Tenant shall pay Landlord all reasonable costs of such performance promptly upon receipt of a bill therefor.

20.3 DAMAGES. Should Landlord elect to terminate this Lease under the provisions of § 20.2 (i) above, Landlord may recover as damages from Tenant the following:

- (a) **Past Rent:** The worth at the time of the award of any unpaid Rent which had been earned at the time of termination; plus
- (b) **Rent Prior to Award:** The worth at the time of the 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 Tenant proves could have been reasonably avoided; plus
- (c) **Rent After Award:** The worth at the time of the award of the amount by which the unpaid Rent for the balance of the Term after the time of award exceeds the amount of the rental loss that Tenant proves could have been reasonably avoided; plus
- (d) **Proximately Caused Damages:** Any other amount necessary to compensate Landlord for all detriment proximately caused by Tenant'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, any costs or expenses (including attorneys' fees), incurred by Landlord in (i) retaking possession of the Premises; (ii) maintaining the Premises after Tenant's default; (iii) preparing the Premises for reletting to a new tenant, including any repairs or alterations; and (iv) reletting the Premises, including brokers' commissions.

"The worth at the time of the award" as used in subsections (a), (b), and (c) above is to be computed at the discount rate of the Federal Reserve Bank situated nearest to the Premises at the time of the award plus one percent (1%).

20.4 LANDLORD'S DEFAULT. If Landlord fails to perform any covenant, condition, or agreement contained in this Lease within thirty (30) days after receipt of written notice from Tenant specifying a default and the relevant Lease provision, or if Landlord fails within that thirty-day period after notice to

commence to cure any such default which cannot reasonably be cured within thirty (30) days, then, subject to § 21.1 below, Landlord shall be liable to Tenant for any damages sustained by Tenant as a result of Landlord's breach. Tenant shall not have the right to terminate this Lease or to withhold, reduce, or offset any amount against any payments of Rent or any other charges due and payable under this Lease, except to the extent that a specific Lease provision permits such termination or withholding, reduction, or offset of Rent.

20.4.1 Tenant's Right to Cure. If Landlord defaults in the performance of any of its obligations under this Lease, Tenant may (but shall not be obligated to), without waiving such default, after the expiration of all applicable notice and cure periods, perform the same for the account and at the expense of Landlord. Landlord shall pay Tenant all reasonable costs of such performance promptly upon receipt of a bill therefor.

20.4.2 Holder's Right to Cure. Tenant shall give any Holder a copy, by certified mail with return receipt requested, of any notice of default served upon Landlord, provided that Tenant previously has been notified in writing of the address of such Holder. If Landlord fails to cure such default within the time provided in this Lease, any such Holder shall have an additional thirty (30) days within which to cure such default by Landlord or, if such default cannot reasonably be cured within that time, such additional time as may be necessary, provided that within such thirty-day period the Holder has commenced and is pursuing the remedies necessary to cure such default (including commencement of foreclosure proceedings, if necessary to effect such cure), in which event this Lease shall not be terminated while such remedies are being so pursued.

20.5 SURVIVAL OF REMEDIES. The remedies permitted under this Article 20, the parties' indemnities under §§ 14.4.3, 14.4.4, and 14.4.5, and § 28.5 below shall survive the termination of this Lease.

21 LIMITATIONS ON LANDLORD'S LIABILITY

21.1 PERSONAL LIABILITY. The liability of Landlord to Tenant for any default by Landlord under this Lease or arising in connection herewith or with Landlord's operation, management, leasing, repair, renovation, alteration, or any other matter relating to the Property or the Premises shall be limited to the interest of Landlord in the Property (and the rental proceeds thereof). Under no circumstances shall Landlord ever be liable for consequential or punitive damages, including damages for lost profits or for business interruption. Tenant agrees to look solely to Landlord's interest in the Property (and the rental proceeds thereof) for the recovery of any judgement against Landlord, and Landlord shall not be personally liable for any such judgement or deficiency after execution thereon. The limitations of liability contained in this Article 21 shall apply equally and inure to the benefit of Landlord's present and future partners, beneficiaries, officers, directors, trustees, shareholders, agents, and employees, and their respective partners, heirs, successors, and assigns. Under no circumstances shall any present or future general or limited partner of Landlord (if Landlord is a partnership), or trustee or beneficiary (if Landlord or any partner of Landlord is a trust) or corporate officer, director, or shareholder (if Landlord or any partner of Landlord is a corporation or company) or member (if Landlord is a limited liability company) have any liability for the performance of Landlord's obligations under this Lease.

21.2 LIABILITY UPON TRANSFER. The term *Landlord* as used in this Lease, so far as covenants or obligations on the part of the Landlord are concerned, shall be limited to mean and include only the owner or owners, at the time in question, of the fee title to, or a lessee's interest in a ground lease or master lease of the Property. In the event of any transfer, assignment, or other conveyance or transfer of any such title or interest, Landlord herein named (and in case of subsequent transfers or conveyances, the current grantor) shall be automatically freed and relieved from and after the date of such transfer,

assignment, or conveyance of all liability with respect to the performance of any covenants or obligations on the part of Landlord contained in this Lease thereafter to be performed, except for return of the Security Deposit, unless transferred to the successor Landlord; and, without further agreement, the

transferee of such title or interest shall be deemed to have assumed and agreed to observe and perform any and all obligations of Landlord hereunder, during its ownership of the Premises. Landlord may transfer its interest in the Premises without the consent of Tenant, and such transfer or subsequent transfer shall not be deemed a violation on Landlord's part of any of the terms and conditions of this Lease.

22 ESTOPPEL CERTIFICATES

22.1 REQUEST AND DELIVERY. Within ten (10) business days following any written request either party may make from time to time, the other party without any charge therefor, shall execute, acknowledge, and deliver a statement certifying the following: (a) the Commencement Date of this Lease; (b) the fact that this Lease is unmodified and in full force and effect or, if there have been modifications hereto, that this Lease is in full force and effect, as modified, and stating the date and nature of such modifications; (c) the date to which the Rent and other sums payable under this Lease have been paid; (d) the fact that there are no current defaults under this Lease by either Landlord or Tenant except as specified in the statement; and (e) such other matters as may be reasonably requested by such party. Landlord and Tenant intend that any statement delivered pursuant to this Article 22 may be relied upon by any Holder, Lessor, beneficiary, purchaser, or prospective purchaser of the Building, the Complex, or any interest therein. A party's failure to deliver any such statement within the specified ten-day period shall constitute a material default hereunder, and a party shall indemnify, defend, protect, and hold the other party harmless from and against any and all Claims which the other party may sustain or incur as a result of or in connection with a party's failure or delay in delivering such statement.

22.2 ELECTION TO SELL BUILDING. If Landlord elects to sell the Building or to obtain loans secured by a lien on the Building, Tenant, promptly after demand, shall include with the estoppel certificate(s) provided to any prospective purchaser or lender as required under this Article 22 any financial statements of Tenant reasonably required by the purchaser or lender. The financial statements so provided shall be kept confidential as to any parties other than the purchaser or lender.

23 NOTICES

23.1 MANNER OF DELIVERY. Any notice required or permitted under this Lease shall be in writing and shall be delivered in at least one of the following ways: (a) personally or by private hand-delivery messenger service; (b) by depositing the same in the United States mail, postage prepaid, registered or certified, return receipt requested; or (c) by depositing such notice, postage prepaid, with Federal Express or another nationally-recognized private overnight delivery service. Each such notice shall be addressed to the intended recipient at such party's address set forth as follows, or at such other address as such party has theretofore specified by written notice delivered in accordance with this § 23.1:

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if to Landlord:

copy to:

if to Tenant:

copies to:

and

23.2 REQUIRED CONTENTS. Every notice (other than the giving or withholding of consent or approval under the provisions of the Lease) given to a party shall state the section of the Lease pursuant to which the notice is given; the period of time within which the recipient of the notice must respond (or, if no response is required, a statement to that effect); and if applicable, that the failure to object to the notice within the stated time period will be deemed to be the equivalent of the recipient's approval, consent to, or satisfaction with the subject matter of the notice.

23.3 PRESUMPTION OF RECEIPT. Any notice delivered personally or by private messenger service during normal business hours shall be deemed delivered on the day delivered to the recipient's address. Any notice delivered by Federal Express or another nationally-recognized private overnight delivery service shall be deemed delivered on the earlier of (y) the second day following deposit thereof with the carrier or (z) the delivery date shown on the carrier's record of delivery. Any notice delivered by mail in the manner specified in § 23.1 shall be deemed delivered on the earlier of (a) the third day following deposit thereof in the United States Mail or (b) the delivery date shown on the return receipt prepared in connection therewith. Refusal by Tenant or Landlord to accept notice delivered in accordance with any of the foregoing means shall constitute a waiver of such notice by the refusing party.

24 BROKERS

24.1 TENANT'S REPRESENTATION. Tenant represents and warrants to Landlord that Tenant has dealt with no broker in connection with this Lease other than (Tenant's broker) and (Landlord's broker). Each party shall be responsible for all foreseeable consequences of damages (including attorneys' fees and costs) resulting from any claims that may be asserted against the other party by any other broker, finder, or other person with whom a party has or purportedly has dealt in connection with this Lease, and each party agrees to indemnify, defend, protect, and hold the other party harmless in connection with any such Claims which may be asserted. Payment of brokers' commissions and fees is the subject of separate agreement by and among the parties hereto and the named brokers.

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25 RIGHTS RESERVED TO LANDLORD

25.1 ACCESS TO PROPERTY. All of the Property except the inside surfaces of all walls, windows, and doors bounding the Premises (including exterior Building walls, core corridor walls and doors, and any core corridor entrance) and any space in or adjacent to the Premises used for shafts, stacks, pipes, conduits, fan rooms, ducts, electric, or other utilities, sinks or other Building facilities, and the use thereof, as well as access thereto through the Premises for the purpose of operation, maintenance, decoration, and repair, are reserved to Landlord. Tenant shall permit Landlord to install, use, replace, and maintain pipes, ducts, and conduits within the demising walls, bearing columns, and ceilings of the Premises, so long as Landlord's exercise of such rights is done in such a manner as to minimize all unreasonable disruption to the conduct of Tenant's business in the Premises.

25.2 CONTROL OF PROPERTY. Except to the extent expressly limited herein, Landlord reserves full rights to control the Property (which rights may be exercised without subjecting Landlord to claims for constructive eviction, abatement of Rent, damages, or other claims of any kind), including more particularly the following rights:

- (a) **Name, Address, Access.** To change the name or street address of the Property; install and maintain signs on the exterior and interior of the Property; retain at all times, and use in appropriate instances, keys to all doors within and into the Premises; grant to any Person the right to conduct any business or render any service at the Property, whether or not it is the same or similar to the use permitted Tenant by this Lease; and have access for Landlord and other tenants of the Property to any mail chutes located on the Premises according to the rules of the United States Postal Service.
- (b) **Entry into Premises.** To enter the Premises at reasonable hours for reasonable purposes upon not less than two (2) days' prior written notice, except in the case of an emergency or to provide janitorial services and subject to §§ 1.7.3 and 1.7.4 above, including inspection and supplying cleaning service or other services to be provided Tenant hereunder, to show the Premises to current and prospective lenders, ground lessors, insurers, and prospective purchasers, tenants and brokers, at reasonable hours; and if Tenant shall abandon the Premises at any time, or shall vacate the same during the last three (3) months of the Term, to decorate, remodel, repair, or alter the Premises.
- (c) **Safety Measures.** To limit or prevent access to the Property, shut down elevator service, activate elevator emergency controls, or otherwise take such action or preventative measures deemed necessary by Landlord for the safety of tenants or other occupants of the Property or the protection of the Property and other property located thereon or therein, in case of fire, invasion, insurrection, riot, civil disorder, public excitement or other dangerous condition, or threat thereof.
- (d) **Improvements.** To decorate and to make alterations, additions and improvements, structural or otherwise, in or to the Property or any part thereof, and any adjacent building, structure, parking facility, land, street or alley (including changes and reductions in corridors, lobbies, parking facilities and other public areas and the installation of kiosks, planters, sculptures, displays, escalators, mezzanines, and other structures, facilities, amenities and features therein, and changes for the purpose of connection with or entrance into or use of the Property in conjunction with any adjoining or adjacent building or buildings, now existing or hereafter

constructed). In connection with such matters, or with any other repairs, maintenance, improvements or alterations, in or about the Property, Landlord may erect scaffolding and other structures reasonably required, and during such operations may enter upon the Premises and take into and upon or through the Premises, all materials required to make such repairs, maintenance, alterations or improvements, so long as Landlord's exercise of such rights is done in such a manner as to minimize all unreasonable disruption to the conduct of Tenant's business in the Premises, and may close public entry ways, other public areas, restrooms, stairways or corridors.

25.3 LANDLORD'S RIGHT TO MAINTAIN. Except as expressly otherwise provided in this Lease, Landlord shall have no liability to Tenant by reason of any inconvenience, annoyance, interruption, or injury to business arising from Landlord's making any repairs or changes which Landlord is required or permitted to make by this Lease, by any other lease or agreement affecting the Property, or by Law, in or to any portion of the Property, Complex, or the Premises, including the Systems and Equipment and appurtenances of the Property or the Premises, provided that Landlord shall use due diligence with respect thereto and shall perform such work, except in case of emergency, at times reasonably convenient to Tenant and otherwise in such manner as will not materially diminish Tenant's beneficial enjoyment of the Premises for their intended use. Landlord shall provide not less than two (2) days' prior written notice to Tenant whenever any work is to be performed on the electrical system of the Building that could affect the Premises, with such notice to specify the contractor that will perform such work, the work to be done, and the location.

25.4 REASONABLE NOTICE. In connection with entering the Premises to exercise any of the foregoing rights, Landlord shall: (a) provide reasonable advance written or oral notice to Tenant's on-site manager or other appropriate person (except in emergencies, or for routine cleaning or other routine matters), and (b) take reasonable steps to avoid any unreasonable interference with Tenant's business.

26 HOLDING OVER

26.1 HOLDOVER. Unless Landlord expressly agrees otherwise in writing, Tenant shall pay Landlord one hundred fifty percent (150%) of the amount of Rent then applicable prorated on per diem basis for each day Tenant shall retain possession of the Premises or any part thereof after expiration of the Term or earlier termination of this Lease, together with all damages sustained by Landlord on account thereof. The foregoing provisions shall not serve as permission for Tenant to hold over, nor serve to extend the Term, although Tenant shall remain bound to comply with all provisions of this Lease until Tenant vacates the Premises and shall be subject to the provisions of § 11.1 above.

26.2 PERMISSIVE MONTH-TO-MONTH TENANCY. Notwithstanding the foregoing to the contrary, at any time before or after expiration or earlier termination of the Term of the Lease, Landlord may serve notice advising Tenant of the amount of Rent and other terms required, should Tenant desire to

enter a month-to-month tenancy. If Tenant shall hold over more than one full calendar month after such notice, Tenant shall thereafter be deemed a month-to-month tenant, on the terms and provisions of this Lease then in effect, as modified by Landlord's notice, except that Tenant shall not be entitled to any renewal or expansion rights contained in this Lease or any amendments hereto.

27 PARKING

27.1 AVAILABLE PARKING. Subject to the terms and conditions contained in the balance of this Article 27, Landlord agrees to make available free of charge to Tenant during the Term of this Lease and any renewal term up to a maximum of one hundred ninety-three (193) parking spaces on a non-exclusive basis in the area(s) designated by Landlord for parking in the Building's parking lots and/or facility (the "Parking Facility"); provided, that if Tenant exercises its termination right with respect to Suite 400 pursuant to § 1.5.2 above, Tenant's parking allocation shall be reduced to a maximum of one hundred sixty-four (164) parking spaces. Said parking spaces shall be in locations designated by Landlord, and parking shall be on a first-come-first-served, unassigned, nonreserved basis. Landlord reserves the right reasonably to designate different locations or different parking areas for Tenant's use without any liability to Tenant and Tenant agrees that any change shall not give rise to any claims or offset against Landlord hereunder. Tenant shall abide by any and all reasonable parking regulations and rules established from time to time by Landlord or Landlord's parking operator. Landlord reserves the right in its sole and absolute discretion to restrict or prohibit the use of the Parking Facility for any vehicles other than passenger automobiles, such as full-sized vans or trucks. Tenant shall not permit any vehicles belonging to Tenant or Tenant's employees, agents, customers, contractors, or invitees to be loaded, unloaded, or parked in areas other than those designated by Landlord for such activities. A failure to comply with the foregoing provisions shall afford Landlord the right without notice to remove any vehicles involved and to charge the cost to Tenant, which cost shall be immediately due and payable upon demand by Landlord.

27.2 USE AT TENANT'S OWN RISK. Landlord shall have no obligation to monitor the use of the Parking Facility. Tenant's and its employees' use of the Parking Facility shall be at the sole risk of Tenant and its employees. Unless caused by the willful harmful act of Landlord, Landlord shall have no responsibility or liability for any injury or damage to any person or property by or as a result of the use of the Parking Facility (or substitute parking) by Tenant and its employees, whether by theft, collision, criminal activity, or otherwise, and Tenant hereby assumes, for itself and its employees, all risks associated with any such occurrences in or about the Parking Facility. Landlord agrees to instruct its security service to use reasonable efforts to provide escort service to Tenant's employees if requested as an accommodation, subject to the availability of security personnel to accommodate such requests in light of their primary security duties.

28 MISCELLANEOUS PROVISIONS.

28.1 GENERAL DEFINITIONS. The definitions which follow shall apply generally to the provisions of this Lease.

- (a) The term **business days** means Monday through Friday inclusive, excluding Holidays as defined in § 8.1.1 above. Throughout this Lease, wherever *days* is used the term shall refer to calendar days. Wherever the term *business days* is used the term shall refer to business days as defined hereunder.
- (b) The term **mortgage** shall include any mortgage or deed of trust, and the term **mortgagee** shall include a trustee.
- (c) The terms **include, including, and such as** shall each be construed as if followed by the phrase "without limitation." The rule of *ejusdem generis* shall not be applicable to limit a general statement following or referable to an enumeration of specific matters to matters similar to the matters specifically mentioned.

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- (d) The term **obligations under this Lease** and words of like import shall mean the covenants to pay Rent and Additional Rent under this Lease and all of the other covenants and conditions contained in this Lease. Any provision in this Lease that one party or the other or both shall do or not do or shall cause or permit or not cause or permit a particular act, condition, or circumstance shall be deemed to mean that such party so covenants or both parties so covenant, as the case may be.
 - (e) The term **Tenant's obligations hereunder** and words of like import and the term **Landlord's obligations hereunder** and words of like import shall mean the obligations under this Lease which are to be performed or observed by Tenant, or by Landlord, as the case may be. Reference to **performance** of either party's obligations under this Lease shall be construed as "performance and observance."
 - (f) Reference to Tenant being or not being **in default hereunder** or words like import shall mean that Tenant is in default in the performance of one or more of Tenant's obligations hereunder, or that Tenant is not in default in the performance of any of Tenant's obligations hereunder, or that a condition of the character described in § 20.1 above has occurred and continues or has not occurred or does not continue, as the case may be.
 - (g) References to Landlord as having **no liability to Tenant** or being **without liability to Tenant** shall mean that Tenant is not entitled to terminate this Lease or to claim actual or constructive eviction, partial or total, or to receive any credit, allowance, setoff, abatement, or diminution of Rent, or to be relieved in any manner of any of its other obligations hereunder, or to be compensated for loss or injury suffered or to enforce any other kind of liability whatsoever against Landlord under or with respect to this Lease or with respect to Tenant's use or occupancy of the Premises.

- (h) The term **requirements of insurance bodies** and words of like import shall mean rules, regulations, orders, and other requirements of the California Board of Fire Underwriters and/or the California Fire Insurance Rating Organization and/or any other similar body performing the same or similar functions and having jurisdiction or cognizance of the Property and/or the Premises.
- (i) The term **repair** shall be deemed to include restoration and replacement as may be necessary to achieve and/or maintain good working order and condition.
- (j) Reference to **termination of this Lease** includes expiration or earlier termination of the Term of this Lease or cancellation of this Lease pursuant to any of the provisions of this Lease or to Law. Upon a termination of this Lease, the Term and estate granted by this Lease shall end at noon local time of the date of termination as if such date were the date of expiration of the Term of this Lease, and neither party shall have any further obligation or liability to the other after such termination, except as shall be expressly provided for in this Lease and except for any such obligation as by its nature or under the circumstances can only be, or by the provisions of this Lease may be, performed after such termination; and in any event, unless expressly provided to the contrary in this Lease, any liability for a payment or obligation which shall have accrued to or with respect to any period ending at the time of termination shall survive the termination of this Lease.
- (k) The term **in full force and effect** when herein used in reference to this Lease as a condition to the existence or exercise of a right on the part of Tenant shall be

construed in each instance as including the further condition that at the time in question no default on the part of Tenant exists, and no event has occurred which has continued to exist for such period of time (after the notice, if any, required by this Lease), as would entitle Landlord to terminate this Lease or to dispossess Tenant.

- (l) The term **Tenant** shall mean Tenant herein named or any assignee, heir, distributee, executor, administrator, legal representative, or other successor in interest (immediate or remote) of Tenant herein named, while such Tenant or such assignee or other successor in interest, as the case may be, is in possession of the Premises as owner of the Tenant's estate and interest granted by this Lease and also, if Tenant is not a single individual or a corporation, all of the persons, firms, and corporations then comprising Tenant; and their liability hereunder shall be joint and several.

28.2 LIGHT AND AIR. No diminution of light, air or view by any structure which may hereafter be erected (whether or not by Landlord) shall entitle Tenant to any reduction of Rent under this Lease, result in any liability of Landlord to Tenant, or in any other way affect this Lease.

28.3 WAIVER OF TERMS. If either Landlord or Tenant waives the performance of any term, covenant, or condition contained in this Lease, such waiver shall not be deemed to be a waiver of the term, covenant, or condition itself or a waiver of any subsequent breach of the same or any other term, covenant, or condition contained herein. Furthermore, the acceptance of Rent by Landlord shall not constitute a waiver of any preceding breach by Tenant of any term, covenant, or condition of this Lease, regardless of Landlord's knowledge of such preceding breach at the time Landlord accepts such Rent. Failure by Landlord to enforce any of the terms, covenants, or conditions of this Lease for any length of time shall not be deemed to waive or to decrease the right of Landlord to insist thereafter upon strict performance by Tenant. Waiver by Landlord of any term, covenant, or condition contained in this Lease may only be made by a written document signed by Landlord.

28.4 FAILURE TO DELIVER STATEMENTS. Landlord's failure during the Term of this Lease to prepare and deliver any of the Statements, estimates, notices, or bills contemplated or required under this Lease, or Landlord's failure to make a demand, shall not in any way cause Landlord to forfeit or surrender its rights to collect any of the foregoing items of Rent which may have become due during the Term of this Lease.

28.5 ATTORNEY'S FEES. In the event that any action or proceeding (including arbitration) is brought to enforce or interpret any term, covenant, or condition of this Lease on the part of Landlord or Tenant, the prevailing party in such action or proceeding (whether after trial or upon appeal) shall be entitled to recover from the party not prevailing its expenses therein, including reasonable attorneys' fees and all allowable costs as fixed by the court.

28.6 JURY TRIAL. Tenant and Landlord each hereby waive their respective rights to a trial by jury under applicable Laws in the event of any litigation or dispute between Landlord and Tenant arising out of or in connection with this Lease and the parties' performance thereunder.

28.7 MERGER. Notwithstanding the acquisition (if same should occur) by the same party of the title and interests of both Landlord and Tenant under this Lease, there shall never be a merger of the estates of Landlord and Tenant under this Lease, but instead the separate estates, rights, duties, and obligations of Landlord and Tenant, as existing hereunder, shall remain unextinguished and continue, separately, in full

force and effect until this Lease expires or otherwise terminates in accordance with the express provisions herein contained.

28.8 NO MERGER ON VOLUNTARY SURRENDER. A voluntary or other surrender of this Lease by Tenant or the mutual cancellation of this Lease shall not work a merger and shall, at the option of Landlord, terminate all or any existing subleases or subtenancies, or may, at the option of Landlord, operate as an assignment to it of any or all such subleases or subtenancies.

28.9 CONSENT. Notwithstanding anything contained in this Lease to the contrary, Tenant shall have no claim and hereby waives the right to any claim against Landlord for money damages by reason of any refusal, withholding, or delaying by Landlord of any consent, approval, statement, or satisfaction; and

in such event, Tenant's only remedies therefor shall be an action for specific performance, injunction, or declaratory judgment to enforce any right to such consent, approval, statement, or satisfaction.

28.10 COUNTERPARTS. This Lease may be executed in multiple counterparts, each of which shall be deemed an original and all of which together shall constitute one and the same instrument.

28.11 FINANCIAL STATEMENTS. In order to induce Landlord to enter into this Lease, Tenant agrees that it shall promptly furnish Landlord, from time to time, upon Landlord's written request, with financial statements reflecting Tenant's current financial condition. Tenant represents and warrants that all financial statements, records, and information furnished by Tenant to Landlord in connection with this Lease are and shall be true, correct, and complete in all respects.

28.12 GENDER AND NUMBER. Words used in neuter gender include the feminine and masculine, where applicable, and words used in the singular or plural shall include the opposite number if appropriate.

28.13 JOINT AND SEVERAL OBLIGATION. If more than one person executes this Lease as Tenant, each of them is jointly and severally liable for the keeping, observing, and performing of all of the terms, covenants, conditions, provisions, and agreements of this Lease to be kept, observed, and performed by Tenant. The term *Tenant* as used in this Lease shall mean and include each of such signatories jointly and severally. The act of or notice from, or notice or refund to, or the signature of, any one or more of such signatories with respect to the tenancy or this Lease, including any renewal, extension, expiration, termination, or modification of this Lease, shall be binding upon each and all of the persons executing this Lease as Tenant with the same force and effect as if each and all of them had so acted or so given or received such notice or refund or so signed.

28.14 HEADINGS AND SECTION NUMBERS. The headings and titles of the articles and sections of this Lease are used for convenience only and shall have no effect upon the construction or interpretation of this Lease. Wherever a reference is made in this Lease to a particular article or section, such reference shall be deemed to include all subsections following such section reference, unless the contrary is expressly provided in connection with such reference. All references in this Lease to numbered articles, numbered sections, and lettered exhibits are references to articles and sections of this Lease and exhibits annexed to (and thereby made part of) this Lease, as the case may be, unless expressly otherwise designated in the context.

28.15 APPLICABLE LAW. This Lease shall in all respects be governed by and interpreted in accordance with the laws of the State of California.

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28.16 SEVERABILITY. If any provision of this Lease or the application thereof to any person or circumstance shall be invalid or unenforceable to any extent, the remainder of this Lease and the application of such provision to other persons or circumstances shall not be affected thereby and shall be enforced to the greatest extent permitted by law.

28.17 SIGNS. Tenant shall not place or permit to be placed in or upon the Premises where visible from outside the Premises or any part of the Building, any signs, notices, drapes, shutters, blinds or window coatings, or displays of any type without the prior written consent of Landlord. Landlord shall consent to the location at the cost of Tenant of a building standard sign on or near the entrance of the Premises and shall include Tenant in the Building and Complex directories located in the Building. Landlord reserves the right in Landlord's sole discretion to place and locate on the roof and exterior of the Building and Complex and in any area of the Building and the Complex not leased to Tenant, such signs, notices, displays and similar items as Landlord deems appropriate in the proper operation of the Building and the Complex. Notwithstanding the foregoing, Tenant shall have the right, at Tenant's sole cost and expense, to install a prominent exterior monument sign, subject to applicable Laws and Landlord's reasonable approval.

28.18 EXECUTION BY LANDLORD. The submission of this document for examination and negotiation does not constitute an offer to lease, or a reservation of, or option for, the Premises. This document becomes effective and binding only upon execution and delivery hereof by Tenant and by Landlord. No act or omission of any employee or agent of Landlord or of Landlord's broker shall alter, change or modify any of the provisions hereof.

28.19 USE OF NAME. Tenant shall not use the name of the Building or Complex for any purpose other than the address of the business to be conducted by Tenant in the Premises. Tenant shall not use any picture of the Building or Complex in its advertising, stationery or in any other manner so as to imply that the entire Building or Complex is leased by Tenant. Landlord expressly reserves the right at any time to change the name or street address of the Building and/or Complex without in any manner being liable to Tenant therefor.

28.20 NONRECORDABILITY OF LEASE. Tenant agrees that in no event shall this Lease or a memorandum hereof be recorded without Landlord's express prior written consent, which consent Landlord may withhold in its sole discretion.

28.21 CONSTRUCTION. All provisions hereof, whether covenants or conditions, shall be deemed to be both covenants and conditions. The definitions contained in this Lease, shall be used to interpret the Lease. All rights and remedies of Landlord and Tenant shall, except as otherwise expressly provided, be cumulative and non-exclusive of any other remedy at law or in equity.

28.22 FORCE MAJEURE DELAYS. This Lease and the obligations (other than monetary obligations) of either party hereunder shall not be affected or impaired because a party is unable to fulfill any of its obligations (other than monetary obligations) hereunder or is delayed in doing so, if such inability or delay is caused by reason of force majeure, strike, labor troubles, acts of God, acts of government, unavailability of materials or labor, or any other cause beyond the reasonable control of such party (collectively "Force Majeure Delays").

28.23 AUTHORITY. If either party is a corporation, each individual executing this Lease on behalf of each such party represents and warrants that such party is qualified to do business in California and that he is duly authorized to execute and deliver this Lease on behalf of such party and shall deliver

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appropriate certification to that effect if requested. If either party is a limited liability company, partnership, joint venture, or other unincorporated association, each individual executing this Lease on behalf of such party represents and warrants that he is duly authorized to execute and deliver this Lease on behalf of such party and that this Lease is binding on such party. Furthermore, each party agrees that the execution of any written consent hereunder, or any written modification or termination of this Lease, by any general partner or member of such party or any other authorized agent of such party shall be binding on such party.

28.24 NONDISCLOSURE. Tenant agrees that it shall not disclose any of the matters set forth in this Lease or disseminate or distribute any information concerning the terms, covenants, or conditions thereof to any person, firm, or entity, other than a prospective assignee or subtenant of the Premises, without first obtaining the express written approval of Landlord; provided, however, that Tenant may disclose the contents of this Lease to any director, officer, or employee of Tenant, to Tenant’s lawyers, accountants, or other third party consultants or professionals, to any lenders, investors, or others to whom Tenant provides financial statements, or in response to any legally effective demand for disclosure pursuant to court order or from any other properly constituted legal authority.

28.25 QUIET ENJOYMENT. So long as Tenant is not in default under this Lease, Tenant shall have quiet enjoyment of the Premises for the Term, subject to all the terms and conditions of this Lease and all liens and encumbrances prior to this Lease.

28.26 EXHIBITS AND ATTACHMENTS. All exhibits and attachments referred to in the body of this Lease are deemed attached hereto and incorporated herein by reference. The parties have attached the following exhibits to the Lease prior to execution:

Exhibit A	Site Plan
Exhibit B	Floor Plans of Premises
Exhibit C	Rules and Regulations
Exhibit D	Athletic Facility Use Agreement
Exhibit E	Commencement Date Agreement
Exhibit F	Work Letter Agreement

28.27 ENTIRE AGREEMENT. This Lease, together with its exhibits, contains all the agreements of the parties hereto and supersedes any previous negotiations. There have been no representations made by the Landlord or understandings made between the parties other than those set forth in this Lease and its exhibits. This Lease may not be modified except by a written instrument duly executed by the parties hereto.

IN WITNESS WHEREOF, the parties have executed this Lease as of the date first above written.

Landlord: _____

By: _____

Tenant: _____

By: _____

Its: _____

By: _____

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O Y S T E R P O I N T M A R I N A P L A Z A

First Addendum to Office Lease

THIS FIRST ADDENDUM TO OFFICE LEASE (the "First Addendum") is made and entered into as of December 15, 2004, by and between _____, a California corporation ("Landlord") and _____, a Delaware limited partnership ("Tenant").

Recitals

A. Landlord and Tenant have heretofore entered into that certain lease dated June 1, 2003 (the "Lease") for premises described as Suite _____ & 400 (the "Premises"), initially containing approximately _____ rentable square feet, in the building located at 395 Oyster Point Boulevard, South San Francisco, California (the "Building"), which forms part of the office building complex commonly known as Oyster Point Marina Plaza (the "Complex").

B. The parties mutually desire to amend the terms of the Lease so as to expand the Premises by the addition of Suite 401 containing approximately 1,250 rentable square feet of space and in certain other respects, all on and subject to the terms and conditions hereof.

Agreement

Now, therefore, in consideration of the mutual terms and conditions herein contained and of other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

1 EFFECT OF ADDENDUM. Landlord and Tenant agree that, notwithstanding anything contained in the Lease to the contrary, the provisions set forth below will be deemed to be part of the Lease and shall supersede, to the extent they differ, any contrary provisions in the Lease. Terms defined in the Lease shall have the same meanings in this First Addendum, unless a different definition is set forth in this First Addendum.

2 EFFECTIVE DATE. The amendments and changes specified in this First Addendum shall become effective on **January 1, 2005** (the "Effective Date"). Notwithstanding the foregoing, this First Addendum shall constitute the fully-binding agreement and contract of the parties from and after the date of the parties' execution and delivery to each other of this First Addendum.

3 EXPANSION OF PREMISES. Upon the Effective Date, the Premises shall be expanded by the addition of Suite 401 containing approximately 1,250 rentable square feet of space in the Building ("Suite 401") for all purposes under the Lease; and all references in the Lease to the "Premises" shall refer to the combination of both the existing Premises under the Lease and Suite 401 from and after the Effective Date. The floor plan and location of Suite 401 is shown on **Exhibit A** which is attached hereto and incorporated herein by reference. The parties agree that, upon the Effective Date, Suite 401 shall become part of the Premises pursuant to the basic terms specified in the Table below (as hereby amended) regarding Term, Base Rent,

Tenant's Share of increases in Operating Expenses and Taxes, and the Base Year for the purposes of calculating Additional Rentable payable with respect to Suite 401.

3.1 Early Occupancy. Notwithstanding anything to the contrary herein, Tenant shall be permitted early entry to Suite 401 from and after the date of the parties' execution and delivery to each other of this First Addendum for the purpose of installing Tenant's telephone and data network cables and wiring, provided that Tenant does not interfere with the performance of Landlord's Work Suite 401 (if any); but

shall not be obligated to begin paying Base Rent therefore until the Effective Date, as specified in the Table below.

4 TABLE. The Table set forth in § 1.3 of the Lease is hereby superseded and replaced in its entirety by the following table, which shall constitute the Table under § 1.3 of the Lease for all purposes from and after the Effective Date of this First Addendum:

PERIOD	SUITE NO.	RSF	USF	MONTHLY BASE RENT	T'S SHARE BLDG	T'S SHARE COMPLEX	BASE YEAR
March 1, 2004, to February 28, 2005	400	8,448	7,346	\$ 14,784.00	3.630%	1.819%	2004
January 1, 2005, to February 28, 2005	401	1,250	1,087	\$ 2,000.00	0.537%	0.269%	2004
March 1, 2005 to February 28, 2006	400	8,448	7,346	\$ 15,206.40	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,000.00	0.537%	0.269%	
March 1, 2006 to February 28, 2007	400	8,448	7,346	\$ 15,628.80	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,062.50	0.537%	0.269%	
March 1, 2007 to February 29, 2008	400	8,448	7,346	\$ 16,051.20	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,125.00	0.537%	0.269%	
March 1, 2008 to February 28, 2009	400	8,448	7,346	\$ 16,473.60	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,187.50	0.537%	0.269%	
March 1, 2009 to February 28, 2010	400	8,448	7,346	\$ 16,896.00	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,250.00	0.537%	0.269%	
March 1, 2010 to February 28, 2011	400	8,448	7,346	\$ 17,318.40	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,312.50	0.537%	0.269%	
March 1, 2011 to February 29, 2012	400	8,448	7,346	\$ 17,740.80	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,375.00	0.537%	0.269%	
March 1, 2012 to February 28, 2013	400	8,448	7,346	\$ 18,163.20	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,437.50	0.537%	0.269%	
March 1, 2013 to February 28, 2014	400	8,448	7,346	\$ 18,585.60	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,500.00	0.537%	0.269%	2004
TOTALS:							

5 AMENDMENT OF RENT. From and after the Effective Date, the Base Rent reserved in § 1.6(a) of the Lease is hereby amended to that specified in the Table in ¶ 4 above with respect to the various spaces and time periods referenced therein. Tenant shall pay to Landlord the first month's Base Rent with respect to Suite 401 upon Tenant's execution and delivery of this First Addendum to Landlord.

5.1 Suite 400 Base Rent Abatement. Notwithstanding anything to the contrary in this First Addendum (including the Table above) Tenant's Abatement Period with respect to Suite 400 provided under § 1.6.3 of the Lease remains in effect, provided that said § 1.6.3 of the Lease is hereby amended and restated as follows:

*Notwithstanding anything to the contrary in this § 1.6 or § 1.3 above, beginning on **March 1, 2004**, Tenant's Monthly Installment of Base Rent with respect to Suite 400 only shall be abated for a period of eighteen (18) months (the "Abatement Period"). The parties agree that the Abatement Period shall terminate on **September 1, 2005**. If Tenant shall materially default under the Lease and fail to cure within the time permitted for cure thereunder, while the Abatement Period is still in effect, the Abatement Period shall thereupon terminate, and Tenant shall commence paying the Base Rent under the Lease as specified in the Table.*

6 BASE YEAR AND ADDITIONAL RENT. As specified in the Table below, the Base Year for the purposes of Article 4 of the Lease from and after the Effective Date shall be calendar year **2004** with respect to Suite 401.

7 CONDITION OF PREMISES. Tenant shall accept Suite 401, any existing Improvements in Suite 401, and the Systems and Equipment serving the same in an “as is” condition on the Effective Date, and Landlord shall have no obligation to improve, alter, remodel, or otherwise modify the Suite 401 in connection with Tenant’s occupancy of the Premises from and after the Effective Date.

7.1 Landlord’s Work; Improvement Allowance. Notwithstanding anything to the contrary in ¶ 4 above, Landlord agrees to provide an improvement allowance in the amount of **Four Thousand Nine Hundred Fifteen Dollars (\$4,915.00)** toward the cost of any work or improvements that Tenant may elect to install in Suite 401, subject to Article 9 of the Lease, after the Effective Date hereof. If Tenant elects to implement any such Changes in Suite 401, Landlord shall use reasonable diligence in completing the approved work in Suite 401 for Tenant. The facilities, materials, and work to be furnished, installed, and performed in Suite 401 by Landlord are referred to as the “Work.” Any other installations, materials, and work which may be undertaken by or for the account of Tenant to prepare, equip, decorate, and furnish Suite 401 are referred to as the “Tenant’s Work.” If required by Landlord, Tenant agrees to enter into an appropriate work letter agreement to reflect the parties’ agreement with respect to any such Changes in Suite 401 and the expenditure of the improvement allowance granted under this ¶ 7.1.

7.1.1 Occupancy during Work. The parties acknowledge that Tenant shall be in possession of the Premises and shall conduct its business in the Premises during the Work contemplated under ¶ 7.1 above. Landlord shall have no liability to Tenant, nor shall Tenant’s obligations under the Lease be reduced or abated in any manner whatsoever, by reason of any inconvenience, annoyance, interruption, or injury to business arising from Landlord’s performance of the Work or from Landlord’s making any repairs or changes which Landlord is required or permitted to perform by the Lease. Landlord shall nevertheless use reasonable efforts to minimize any interference with Tenant’s business in the Premises. Landlord agrees to use reasonable efforts to avoid interference with Tenant’s use and occupancy of the Premises during the performance of the Work and agrees to cause the application of paint and any work generating unreasonable noise outside of normal business hours. The parties agree that Landlord shall not be liable for any damages which Tenant may incur during the performance of the Work, except to the extent that Tenant’s actual damages are the result of Landlord’s negligence or willful misconduct. In no circumstances shall Landlord be liable to Tenant for business interruption, lost profits, or compensatory or consequential damages of any kind by virtue of Landlord’s Work. Tenant specifically agrees that any interference with Tenant’s use or occupancy of the Premises caused by the performance of the Work shall not constitute a constructive eviction.

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7.2 Notice of Defects. It shall be conclusively presumed upon Tenant’s taking actual possession of Suite 401 that the same were in satisfactory condition (except for latent defects) as of the date of such taking of possession, unless within thirty (30) days after the Effective Date Tenant shall give Landlord notice in writing specifying the respects in which Suite 401 was not in satisfactory condition.

8 TENANT’S SUPPLEMENTARY IMPROVEMENT ALLOWANCE. Notwithstanding anything to the contrary in ¶ 3 of the Work Letter Agreement, the parties agree that, during the performance of Landlord’s Work under the Work Letter Agreement, Tenant elected to apply of sum of Sixty Thousand Dollars (\$60,000) referenced in said ¶ 3 to improvements other than the Southeast Wing HVAC portion of the Supplemental HVAC system in the 5th Floor of the Premises as required under § 3.2 of the Lease and that Landlord’s entire obligation under the Work Letter Agreement with respect to the Southeast Wing HVAC portion of the Supplemental HVAC system in the 5th Floor of the Premises as required under § 3.2 of the Lease has been fully and completely discharged.

9 Tenant’s Termination Right. From and after the Effective Date the parties agree that Suite 401 shall be deemed part of Suite 400 for the purpose of exercising Tenant’s Suite 400 termination right under § 1.5.2 of the Lease; provided, that said § 1.5.2 is hereby amended in its entirety to read as follows:

***Suite 400 Termination Right.** Notwithstanding anything to the contrary herein, Tenant shall have the right to terminate the Lease with respect to Suites 400 and 401 only effective on either **September 30, 2008**, or **September 30, 2010**, upon written notice given to Landlord not less than six (6) months and not more than nine (9) months prior to either such termination date that may be selected by Tenant. If Tenant exercises such termination right, Tenant shall pay to Landlord a termination fee on the termination date of either **One Hundred Seven Thousand Five Hundred Thirteen Dollars and Forty Cents (\$107,513.40)**, if Tenant exercises its right to terminate the Lease with respect to Suites 400 and 401 on September 30, 2008, or **Seventy-Seven Thousand Three Hundred Thirty-Four Dollars and Twenty Cents (\$77,334.20)**, if Tenant exercises its right to terminate the Lease with respect to Suites 400 and 401 on September 30, 2010.*

10 PARKING. The number of parking spaces designated for Tenant’s use under § 27.1 of the Lease shall be increased from and after the Effective Date from the number stated in the Lease to up to a maximum of One Hundred Ninety-Seven (197) parking spaces on a non-exclusive basis in the area(s) designated by Landlord for parking in the Building’s parking lots.

11 NO DISCLOSURE. Tenant agrees that it shall not disclose any of the matters set forth in this First Addendum or disseminate or distribute any information concerning the terms, details, or conditions hereof to any person, firm, or entity without obtaining the express written approval of Landlord.

12 SURVIVAL. Warranties, representations, agreements, and obligations contained in this First Addendum shall survive the execution and delivery of this First Addendum and shall survive any and all performances in accordance with this First Addendum.

13 COUNTERPARTS. This First Addendum may be executed in any number of counterparts, which each severally and all together shall constitute one and the same First Addendum.

14 ATTORNEYS’ FEES. If any party obtains a judgement against any other party or parties by reason of breach of this First Addendum, reasonable attorneys’ fees and costs as fixed by the court shall be included in such judgement against the losing party or parties.

15 SUCCESSORS. This First Addendum and the terms and provisions hereof shall inure to the benefit of and be binding upon the heirs, successors, and assigns of the parties.

16 AUTHORITY. Each of the individuals executing this First Addendum represents and warrants that he or she is authorized to execute this First Addendum on behalf of the party for whom he or she is

executing this First Addendum and that by his or her signature such party is legally bound by the terms, covenants, and conditions of this First Addendum.

17 GOVERNING LAW. This First Addendum shall be construed and enforced in accordance with the laws of the State of California.

18 CONTINUING VALIDITY OF LEASE. Except as expressly modified herein, the Lease remains in full force and effect, and its provisions shall apply equally to the Expansion Space as to the remainder of the Premises, including (i) Tenant's termination right under § 1.5.2 of the Lease with respect to Suite 400, of which the Expansion Space shall be deemed a part of the purposes of exercising Tenant termination right thereunder; (ii) the exercise of Tenant's Extension Option under § 1.5.1 of the Lease; and (iii) Tenant's Security Deposit stated under § 5.1 of the Lease, which shall remain unchanged by this First Addendum.

19 CONFLICTS. In the event of any conflict between the provisions of the Lease and those of this First Addendum, the terms and provisions of this First Addendum shall control.

20 WHOLE AGREEMENT. The mutual obligations of the parties as provided herein are the sole consideration for this First Addendum, and no representations, promises, or inducements have been made by the parties other than as appear in this First Addendum, which supersedes any previous negotiations. There have been no representations made by the Landlord or understandings made between the parties other than those set forth in this First Addendum. This First Addendum may not be amended except in writing signed by all the parties.

In witness whereof, the parties have executed this First Addendum as of the date first above written.

Landlord:

Tenant:

By: _____

By: _____

Its: _____

By: _____

[Exhibit A]

[Suite 401]

O Y S T E R P O I N T M A R I N A P L A Z A

Second Addendum to Office Lease

THIS SECOND ADDENDUM TO OFFICE LEASE (the "Second Addendum") is made and entered into as of March 1, 2005, by and between _____, a California corporation ("Landlord") and _____, a Delaware limited partnership ("Tenant").

Recitals

A. Landlord and Tenant have heretofore entered into that certain lease dated June 1, 2003 (the "Lease") for premises described as Suites _____ & 400 (the "Premises"), initially containing approximately _____ rentable square feet, in the building located at 395 Oyster Point Boulevard, South San Francisco, California (the "Building"), which forms part of the office building complex commonly known as Oyster Point Marina Plaza (the "Complex").

B. The Lease has heretofore been amended by that certain First Addendum to Office Lease dated as of December 15, 2004 ("the "First Addendum"), under which the parties agreed to expand the Premises by the addition of Suite 401 containing approximately 1,250 rentable square feet of space and in certain other respects, all as set forth in the First Addendum.

C. The parties mutually desire to amend the terms of the Lease so as to expand the Premises by the addition of Suite 402 containing approximately 5,680 rentable square feet of space and in certain other respects, all on and subject to the terms and conditions hereof.

Agreement

Now, therefore, in consideration of the mutual terms and conditions herein contained and of other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

1 EFFECT OF ADDENDUM. Landlord and Tenant agree that, notwithstanding anything contained in the Lease to the contrary, the provisions set forth below will be deemed to be part of the Lease and shall supersede, to the extent they differ, any contrary provisions in the Lease. Terms defined in the Lease shall have the same meanings in this Second Addendum, unless a different definition is set forth in this Second Addendum.

2 EFFECTIVE DATE. The amendments and changes specified in this Second Addendum shall become effective on **April 1, 2005** (the "Effective Date"). Notwithstanding the foregoing, this Second Addendum shall constitute the fully-binding agreement and contract of the parties from and after the date of the parties' execution and delivery to each other of this Second Addendum.

3 TABLE. The Table set forth in § 1.3 of the Lease (as heretofore modified in the First Addendum) is hereby superseded and replaced in its entirety by the following table, which shall constitute the Table under § 1.3 of the Lease for all purposes from and after the Effective Date of this Second Addendum:

7

PERIOD	SUITE NO.	RSF	USF	MONTHLY BASE RENT	SHARE BLDG	SHARE COMPLEX	BASE YEAR
March 1, 2004, to February 28, 2005	400	8,448	7,346	\$ 14,784.00	3.630%	1.819%	2004
January 1, 2005, to February 28, 2005	401	1,250	1,087	\$ 2,000.00	0.537%	0.269%	2004
March 1, 2005 to February 28, 2006	400	8,448	7,346	\$ 15,206.40	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,000.00	0.537%	0.269%	
April 1, 2005, to February 28, 2006	402	5,680	4,939	\$ 9,088.00	2.441%	1.223%	2004
March 1, 2006 to February 28, 2007	400	8,448	7,346	\$ 15,628.80	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,062.50	0.537%	0.269%	
	402	5,680	4,939	\$ 9,372.00	2.441%	1.223%	
March 1, 2007 to February 29, 2008	400	8,448	7,346	\$ 16,051.20	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,125.00	0.537%	0.269%	
	402	5,680	4,939	\$ 9,656.00	2.441%	1.223%	
March 1, 2008 to February 28, 2009	400	8,448	7,346	\$ 16,473.60	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,187.50	0.537%	0.269%	
	402	5,680	4,939	\$ 9,940.00	2.441%	1.223%	
March 1, 2009 to February 28, 2010	400	8,448	7,346	\$ 16,896.00	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,250.00	0.537%	0.269%	
	402	5,680	4,939	\$ 10,224.00	2.441%	1.223%	
March 1, 2010 to February 28, 2011	400	8,448	7,346	\$ 17,318.40	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,312.50	0.537%	0.269%	
	402	5,680	4,939	\$ 10,508.00	2.441%	1.223%	
March 1, 2011 to February 29, 2012	400	8,448	7,346	\$ 17,740.80	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,375.00	0.537%	0.269%	
	402	5,680	4,939	\$ 10,792.00	2.441%	1.223%	
March 1, 2012 to February 28, 2013	400	8,448	7,346	\$ 18,163.20	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,437.50	0.537%	0.269%	
	402	5,680	4,939	\$ 11,076.00	2.441%	1.223%	
March 1, 2013 to February 28, 2014	400	8,448	7,346	\$ 18,585.60	3.630%	1.819%	2004
	401	1,250	1,087	\$ 2,500.00	0.537%	0.269%	
	402	5,680	4,939	\$ 11,360.00	2.441%	1.223%	
TOTALS:							

8

4 EXPANSION OF PREMISES. Upon the Effective Date, the Premises shall be expanded by the addition of Suite 402 containing approximately 5,680 rentable square feet of space in the Building ("Suite 402") for all purposes under the Lease; and all references in the Lease to the "Premises" shall

refer to the combination of both the existing Premises under the Lease as heretofore amended and Suite 402 from and after the Effective Date. The floor plan and location of Suite 402 is shown on **Exhibit A** which is attached hereto and incorporated herein by reference. The parties agree that, upon the Effective Date, Suite 402 shall become part of the Premises pursuant to the basic terms specified in the Table below (as hereby amended) regarding Term, Base Rent, Tenant's Share of increases in Operating Expenses and Taxes, and the Base Year for the purposes of calculating Additional Rentable payable with respect to Suite 402.

4.1 Early Occupancy. Notwithstanding anything to the contrary herein, Tenant shall be permitted early entry to Suite 402 from and after the date of the parties' execution and delivery to each other of this Second Addendum for the purpose of installing Tenant's telephone and data network cables and wiring, provided that Tenant does not interfere with the performance of Landlord's Work Suite 402 (if any); but shall not be obligated to begin paying Base Rent therefore until the Effective Date, as specified in the Table below.

5 AMENDMENT OF RENT. From and after the Effective Date, the Base Rent reserved in § 1.6(a) of the Lease is hereby amended to that specified in the Table in ¶ 3 above with respect to the various spaces and time periods referenced therein. Tenant shall pay to Landlord the first month's Base Rent with respect to Suite 402 upon Tenant's execution and delivery of this Second Addendum to Landlord.

6 BASE YEAR AND ADDITIONAL RENT. As specified in the Table above, the Base Year for the purposes of Article 4 of the Lease from and after the Effective Date shall be calendar year **2004** with respect to Suite 402.

7 CONDITION OF PREMISES. Except as provided in ¶ 7.1 below, Tenant shall accept Suite 402, any existing Improvements in Suite 402, and the Systems and Equipment serving the same in an "as is" condition on the Effective Date, and Landlord shall have no obligation to improve, alter, remodel, or otherwise modify the Suite 402 in connection with Tenant's occupancy of the Premises from and after the Effective Date.

7.1 Landlord's Work. Landlord shall use reasonable diligence in completing and preparing the Suite 402 for Tenant's occupancy on or before the Effective Date; provided, however, that the commencement date for the lease of Suite 402 shall be the Effective Date, and Tenant shall begin paying Rent therefore on the Effective Date, regardless of whether Landlord's Work (as defined below) is substantially completed on or before the Effective Date or not. The facilities, materials, and work to be furnished, installed, and performed in Suite 402 by Landlord are referred to as the "Work." Any other installations, materials, and work which may be undertaken by or for the account of Tenant to prepare, equip, decorate, and furnish Suite 402 are referred to as the "Tenant's Work," which shall include the connection and/or rewiring of Tenant's telephone and data lines. The parties agree that Landlord's Work shall consist of the following items only, to be completed at Landlord's sole cost and expense:

- (i) Landlord shall re-activate the corridor in the Suite 402 wing and install Building-standard carpet, wall covering, and light fixtures in Suite 402 wing corridor; and
- (ii) Landlord shall construct a demising wall for Suite 402.

7.1.1 Occupancy during Work. The parties acknowledge that Tenant may be in possession of the Premises and shall conduct its business in the Premises during the Work contemplated under ¶ 7.1

above. Landlord shall have no liability to Tenant, nor shall Tenant's obligations under the Lease be reduced or abated in any manner whatsoever, by reason of any inconvenience, annoyance, interruption, or injury to business arising from Landlord's performance of the Work or from Landlord's making any repairs or changes which Landlord is required or permitted to perform by the Lease. Landlord shall nevertheless use reasonable efforts to minimize any interference with Tenant's business in the Premises. Landlord agrees to use reasonable efforts to avoid interference with Tenant's use and occupancy of the Premises during the performance of the Work and agrees to cause the application of paint and any work generating unreasonable noise outside of normal business hours. The parties agree that Landlord shall not be liable for any damages which Tenant may incur during the performance of the Work, except to the extent that Tenant's actual damages are the result of Landlord's negligence or willful misconduct. In no circumstances shall Landlord be liable to Tenant for business interruption, lost profits, or compensatory or consequential damages of any kind by virtue of Landlord's Work. Tenant specifically agrees that any interference with Tenant's use or occupancy of the Premises caused by the performance of the Work shall not constitute a constructive eviction.

7.1.2 Notice of Defects. It shall be conclusively presumed upon Tenant's taking actual possession of Suite 402 that the same were in satisfactory condition (except for latent defects) as of the date of such taking of possession, unless within thirty (30) days after the Effective Date Tenant shall give Landlord notice in writing specifying the respects in which Suite 402 was not in satisfactory condition.

7.2 Improvement Allowance. In addition to bearing the cost of the Work specified in ¶ 7.1 above, Landlord agrees to provide to Tenant an improvement allowance in the amount of **Twenty-Eight Thousand Four Hundred Dollars (\$28,400.00)** toward the cost of any work or improvements that Tenant may elect to install in Suite 402, subject to Article 9 of the Lease, after the Effective Date hereof. If Tenant elects to implement any such Changes in Suite 402, Landlord shall use reasonable diligence in completing the approved work in Suite 402 for Tenant. If required by Landlord, Tenant agrees to enter into an appropriate work letter agreement to reflect the parties' agreement with respect to any such Changes in Suite 402 and the expenditure of the improvement allowance granted under this ¶ 7.2.

8 Suite 402 Termination Right. Notwithstanding anything to the contrary in the Lease as herein amended, Tenant shall have the right to terminate the Lease with respect to Suite 402 only effective on **September 30, 2009**, upon written notice given to Landlord not less than six (6) months and not more than nine (9) months prior to such termination date. If Tenant exercises such termination right, Tenant shall pay to Landlord upon exercise of its termination right, together with Tenant's written notice of exercise, a termination fee in the amount of **Fifty-Five Thousand Two Hundred Thirteen Dollars and Twenty Cents (\$55,213.20)**. If Tenant exercises its termination right as herein provided, the Lease with respect to Suite 402 only shall terminate on the effective date of such termination with the same effect as if the Term of the Lease had expired with respect to Suite 402 only. In addition to paying the termination fee to Landlord, Tenant agrees to pay to Landlord upon receipt of Landlord's bill therefor the reasonable cost to Landlord of constructing a new demising wall to separate Suite 402 from Suite 401 following the effective date of the termination provided for herein, if Tenant exercises its termination right with respect to Suite 402 only.

9 SECURITY DEPOSIT. Tenant's Security Deposit required under § 5.1 of the Lease shall remain unchanged in consequence of the parties' execution and delivery of this Second Addendum.

10 EXTENSION OPTIONS. The Extension Option granted to Tenant under § 1.5.1 of the Lease shall apply to Suite 402 equally with the rest of the Premises, as herein and heretofore amended, provided that

Tenant has not exercised its termination right under ¶ 8 above with respect to Suite 402 only prior to Tenant's exercise of such Extension Option.

11 PARKING. The number of parking spaces designated for Tenant's use under § 27.1 of the Lease shall be increased from and after the Effective Date from the number stated in the Lease to up to a maximum of Two Hundred Sixteen (216) parking spaces on a non-exclusive basis in the area(s) designated by Landlord for parking in the Building's parking lots.

12 NO DISCLOSURE. Tenant agrees that it shall not disclose any of the matters set forth in this Second Addendum or disseminate or distribute any information concerning the terms, details, or conditions hereof to any person, firm, or entity without obtaining the express written approval of Landlord.

13 SURVIVAL. Warranties, representations, agreements, and obligations contained in this Second Addendum shall survive the execution and delivery of this Second Addendum and shall survive any and all performances in accordance with this Second Addendum.

14 COUNTERPARTS. This Second Addendum may be executed in any number of counterparts, which each severally and all together shall constitute one and the same Second Addendum.

15 ATTORNEYS' FEES. If any party obtains a judgement against any other party or parties by reason of breach of this Second Addendum, reasonable attorneys' fees and costs as fixed by the court shall be included in such judgement against the losing party or parties.

16 SUCCESSORS. This Second Addendum and the terms and provisions hereof shall inure to the benefit of and be binding upon the heirs, successors, and assigns of the parties.

17 AUTHORITY. Each of the individuals executing this Second Addendum represents and warrants that he or she is authorized to execute this Second Addendum on behalf of the party for whom he or she is executing this Second Addendum and that by his or her signature such party is legally bound by the terms, covenants, and conditions of this Second Addendum.

18 GOVERNING LAW. This Second Addendum shall be construed and enforced in accordance with the laws of the State of California.

19 CONTINUING VALIDITY OF LEASE. Except as expressly modified herein, the Lease remains in full force and effect, and its provisions shall apply equally to the Expansion Space as to the remainder of the Premises, including (i) Tenant's termination right under § 1.5.2 of the Lease with respect to Suite 400, of which the Expansion Space shall be deemed a part of the purposes of exercising Tenant termination right thereunder; (ii) the exercise of Tenant's Extension Option under § 1.5.1 of the Lease; and (iii) Tenant's Security Deposit stated under § 5.1 of the Lease, which shall remain unchanged by this Second Addendum.

20 CONFLICTS. In the event of any conflict between the provisions of the Lease and those of this Second Addendum, the terms and provisions of this Second Addendum shall control.

21 WHOLE AGREEMENT. The mutual obligations of the parties as provided herein are the sole consideration for this Second Addendum, and no representations, promises, or inducements have been made by the parties other than as appear in this Second Addendum, which supersedes any previous negotiations. There have been no representations made by the Landlord or understandings made between the parties other than those set forth in this Second Addendum. This Second Addendum may not be amended except in writing signed by all the parties.

In witness whereof, the parties have executed this Second Addendum as of the date first above written.

Landlord:

Tenant:

By: _____

By: _____
Its: _____

By: _____, President

EXHIBIT B

MASTER LEASE AGREEMENT

EXHIBIT C

DISCLOSURE LIST

EXHIBIT D

MASTER LANDLORD CONSENT

Master Landlord hereby acknowledges receipt of a copy of this Sublease, and consents to the terms and conditions of this Sublease. By this consent, Master Landlord shall not be deemed in any way to have entered the Sublease or to have consented to any further assignment or sublease. Master Landlord further agrees that, notwithstanding anything to the contrary in the Master Lease Agreement:

(a) Master Landlord shall deliver to Subtenant at the address set forth in the Sublease notices of any defaults under the Master Lease Agreement at the same time such notices are sent to Sublandlord as set forth in the Master Lease Agreement and shall permit Subtenant to cure such defaults.

(b) Master Landlord agrees that the release and waiver of subrogation in Section 24 of the Sublease shall apply as between Master Landlord and Subtenant.

(c) In the event that the Master Lease Agreement terminates prior to the expiration of the term thereof, the Sublease shall continue in full force and effect as a direct lease between Master Landlord and Subtenant upon all of the terms, covenants and conditions of the Sublease.

(d) Subtenant may, without Master Landlord's prior written consent, sublet the Premises or assign the Sublease as described in Section 17.12 of the Master Lease Agreement.

MASTER LANDLORD:

a _____ corporation

By: _____

Name: _____

Its: _____

Address: _____

Subsidiaries of Registrant

<u>Name</u>	<u>State or Jurisdiction of Organization</u>
Sunesis Europe Limited	United Kingdom

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements (Form S-3 No. 333-138736 and No. 333-133387), the Registration Statements (Form S-8 No. 333-112826 and No. 333-138758) pertaining to the Sunesis Pharmaceuticals, Inc. 1998 Stock Plan, Sunesis Pharmaceuticals, Inc. 2001 Stock Plan, Sunesis Pharmaceuticals, Inc. 2005 Equity Incentive Award Plan and Sunesis Pharmaceuticals, Inc. Employee Stock Purchase Plan and the Registration Statement (Form S-8 No. 333-132679) pertaining to the Sunesis Pharmaceuticals, Inc. 2006 Employment Commencement Incentive Plan, of our reports dated March 9, 2007 with respect to the financial statements of Sunesis Pharmaceuticals, Inc., Sunesis Pharmaceuticals, Inc. management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of Sunesis Pharmaceuticals, Inc., included in this Annual Report (Form 10-K) for the year ended December 31, 2006.

/s/ Ernst & Young LLP

San Jose, California
March 9, 2007

Certification of Chief Executive Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Daniel N. Swisher, Jr., certify that:

1. I have reviewed this annual report on Form 10-K of Sunesis Pharmaceuticals, Inc.;
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(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this 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(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 15, 2007

/s/ DANIEL N. SWISHER, JR.

Daniel N. Swisher, Jr.

President and Chief Executive Officer

Certification of Chief Financial Officer
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Eric H. Bjerkholt, certify that:

1. I have reviewed this annual report on Form 10-K of Sunesis Pharmaceuticals, Inc.;
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(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this 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(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 15, 2007

/s/ ERIC H. BJERKHOLT

Eric H. Bjerkholt

Senior Vice President, Corporate Development and Finance,
Chief Financial Officer

Certification of Chief Executive Officer
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Sunesis Pharmaceuticals, Inc. (the "Company") hereby certifies, to such officer's knowledge, that:

- (i) the accompanying report on Form 10-K of the Company for the year ended December 31, 2006 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (ii) the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 15, 2007

/s/ DANIEL N. SWISHER, JR.

Daniel N. Swisher, Jr.

President and Chief Executive Officer

Certification of Chief Financial Officer
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Sunesis Pharmaceuticals, Inc. (the "Company") hereby certifies, to such officer's knowledge, that:

- (i) the accompanying report on Form 10-K of the Company for the year ended December 31, 2006 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
- (ii) the information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: March 15, 2007

/s/ ERIC H. BJERKHOLT

Eric H. Bjerkholt
Senior Vice President, Corporate Development and Finance,
Chief Financial Officer
