

GENERAL SECURITY AGREEMENT

THIS AGREEMENT is made as of the 31st day of July, 2003.

BY:

AZURE DYNAMICS INC., a corporation incorporated under the laws of Canada and having its registered office at Calgary, Alberta

(hereinafter the "Debtor")

IN FAVOUR OF:

VALIANT TRUST COMPANY, a trust company having an office in Calgary, Alberta as Trustee for the holders of Debentures dated July 31, 2003 issued by the Debtor and which are governed by the terms of a trust indenture dated July 31, 2003 between Azure Dynamics Corporation and the Secured Party ("Trust Indenture");

(hereinafter the "Trustee")

RECITALS:

WHEREAS

- A. The Trustee has given value to the Debtor; and
- B. The Debtor has agreed to grant the Security Interest to the Trustee to secure its Obligations to the Trustee.

NOW THEREFORE in consideration of the Recitals above and the covenants and agreements herein, the Debtor agrees with the Trustee as follows:

ARTICLE 1
INTERPRETATION

1.1 **Definitions**

In this Agreement:

"Affiliate" has the meaning attributed thereto in the *Business Corporations Act* (Alberta);

"this Agreement", "hereto", "herein", "hereof", "hereby", "hereunder" and any similar expressions refer to this Agreement, including the Recitals and the Schedules hereto as they may be amended or supplemented from time to time, and not to any particular Article, section or other portion hereof or thereof;

"Business Day" means any day, other than Saturday, Sunday or any statutory holiday in the Province of Alberta;

"Collateral" means all of the undertaking, property and assets of the Debtor described in Section 2.1 and subject to, or intended to be subject to, the Security Interest, and any reference to

"Collateral" shall be deemed to be a reference to "Collateral or any part thereof" except where otherwise specifically provided;

"Corporation Intellectual Property" means all Intellectual Property owned by the Debtor or the Parent including that which is listed in Schedule "B" hereto;

"Debenture" means the Series A Secured Convertible Debentures of the Debtor issued or to be issued pursuant to the Trust Indenture and for the time being outstanding;

"Debenture holders" means the person or persons for the time being entered in the registers of the Debtor as the holders of Debentures;

"Event of Default" has the meaning attributed to such term in Section 8.1;

"Guarantee" means the guarantee given by the Debtor to the Trustee guaranteeing the obligations of Azure Dynamics Corporation to the Trustee pursuant to the Trust Indenture;

"Intellectual Property" means all intellectual property, including without limitation, all patents, copyrights, industrial designs, trademarks, trade secrets, confidential information and know-how, whether patentable or not, trade names, goodwill and all other forms of intellectual and industrial property, any and all common law rights and any registrations and applications for registration for any of the foregoing, whether pending or in preparation for filing in any and all jurisdictions of the world;

"Lien" means any mortgage, pledge, charge, assignment, security interest, hypothec, lien or other encumbrance, including, without limitation, any agreement to give any of the foregoing, or any conditional sale or other title retention agreement;

"Obligations" means all of the obligations, liabilities and indebtedness of whatsoever nature or kind of the Debtor owing to the Trustee and the Debenture holders (including interest thereon and legal fees and disbursements on a solicitor and his own client basis) from time to time, whether present or future, absolute or contingent, matured or not, extended or renewed, liquidated or unliquidated wheresoever and howsoever incurred and any ultimate unpaid balance thereof and whether the same is reduced and thereafter increased or entirely extinguished and thereafter incurred again and whether the Debtor be bound alone or with another or others and whether as principal or surety, including those obligations pursuant to the Guarantee;

"Parent" means Azure Dynamics Corporation, of which the Debtor is the wholly-owned subsidiary;

"Permitted Liens" has the same meaning ascribed thereto as in the Trust Indenture;

"Person" includes any individual, partnership, limited partnership, joint venture, syndicate, sole proprietorship, company or corporation with or without share capital, unincorporated association, trust, trustee, executor, administrator or other legal personal representative, regulatory body or agency, government or governmental agency, authority or entity however designated or constituted;

"PPSA" means the *Personal Property Security Act* in force in the jurisdiction wherein the Debtor's personal property is situate from time to time, as amended from time to time and any Act substituted therefor and amendments thereto and the regulations thereunder;

"Receiver" means any of a receiver, manager, receiver-manager and receiver and manager;

"Registered Corporation Intellectual Property" means the applications and registrations for patents and trademarks identified in references 1 to 2 and 11 to 12 in Schedule "B" hereto;

"Security Interest" has the meaning attributed to such term in Section 2.1; and

"Senior Indebtedness" shall have the meaning ascribed thereto as in the Trust Indenture.

1.2 Incorporated PPSA Definitions

In this Agreement, the terms "Accessions", "Account", "Chattel Paper", "Consumer Goods", "Document of Title", "Equipment", "Goods", "Instrument", "Intangible", "Inventory", "Money", "Personal Property", "Proceeds", "Security", "Serial Number Goods" and "Value" shall have the respective meanings attributed to them in the PPSA.

1.3 Headings

The inclusion of headings in this Agreement is for convenience of reference only and shall not affect the construction or interpretation hereof.

1.4 References to Articles and Sections

Whenever in this Agreement a particular Article, section or other portion thereof is referred to then, unless otherwise indicated, such reference pertains to the particular Article, section or portion thereof contained herein.

1.5 Currency

Except where otherwise expressly provided, all amounts in this Agreement are stated and shall be paid in Canadian currency.

1.6 Gender and Number

In this Agreement, unless the context otherwise requires, words importing the singular include the plural and vice versa and words importing gender include all genders.

1.7 Invalidity of Provisions

Each of the provisions contained in this Agreement is distinct and severable and a declaration of invalidity or unenforceability of any such provision or part thereof by a court of competent jurisdiction shall not affect the validity or enforceability of any other provision hereof.

1.8 Amendment, Waiver

No amendment or waiver of this Agreement shall be binding unless executed in writing by the party to be bound thereby. No waiver of any provision of this Agreement shall constitute a waiver of any other provision nor shall any waiver of any provision of this Agreement constitute a continuing waiver unless otherwise expressly provided.

1.9 Governing Law, Attornment

This Agreement shall be governed by and construed in accordance with the laws of the Province of Alberta and the laws of Canada applicable therein and the Debtor hereby irrevocably attorns to the jurisdiction of the courts of Alberta.

1.10 Schedules

The following Schedules are attached hereto and form an integral part of this Agreement:

- Schedule "A" - Collateral - Locations
- Schedule "B" - Azure Dynamics Inc. Intellectual Property - Patents, Patent Applications Filed, and Unregistered Documented Intellectual Property

ARTICLE 2 SECURITY INTEREST

2.1 Creation of Security Interest

As general and continuing security for the payment, performance and satisfaction of the Obligations, and subject to Sections 2.2 and 2.3 hereof, the Debtor hereby grants to the Trustee, in trust for the benefit of the Debenture holders, a security interest (the "Security Interest") in:

- (a) all present and after-acquired Personal Property of the Debtor, including without limitation, all present and after-acquired Goods, Chattel Paper, Documents of Title, Instruments, Intangibles (including Accounts), Money and Securities;
- (b) all present and after-acquired real property of the Debtor;
- (c) all present and after-acquired Corporation Intellectual Property in which the Debtor has an interest;
- (d) all additions and Accessions to any of the foregoing; and
- (e) all Proceeds of any of the foregoing.

2.2 Exception for Last Day of Leases

The Security Interest granted hereby does not and shall not extend to, and Collateral shall not include, the last day of the term of any lease or sublease, oral or written, or any agreement therefor, now held or hereafter acquired by the Debtor, but upon the sale of the leasehold interest (or any part thereof) the Debtor shall stand possessed of such last day in trust to assign the same as the Trustee shall direct.

2.3 Exception for Contractual Rights

The Security Interest granted hereby does not and shall not extend to, and Collateral shall not include, any agreement, right, franchise, license or permit (the "contractual rights") to which the Debtor is a party or of which the Debtor has the benefit, to the extent that the creation of the Security Interest therein would constitute a breach of the terms of or permit any Person to terminate the contractual rights, but the Debtor shall hold its interest therein in trust for the Trustee and shall assign such contractual rights to the Trustee forthwith upon obtaining the consent of the other party thereto. The Debtor agrees that it

shall, upon the request of the Trustee, use all commercially reasonable efforts to obtain any consent required to permit any contractual rights to be subjected to the Security Interest.

2.4 Equal and Rateable Security

The Security Interest is for the equal and rateable benefit of all Debenture holders and the Trustee, without preference or priority of any Debenture over any other Debenture.

2.5 Attachment

The Debtor acknowledges that value has been given and that the attachment of the Security Interest has not been postponed and the Security Interest shall attach to any particular Collateral as soon as the Debtor has rights in such Collateral.

ARTICLE 3 REPRESENTATIONS AND WARRANTIES

3.1 Representations and Warranties

The Debtor represents and warrants, and so long as this Agreement remains in effect shall be deemed continuously to represent and warrant, that:

- (a) it is duly incorporated and validly existing under the laws of its jurisdiction of incorporation and has the corporate power and capacity to own its properties and assets and to carry on its business as presently carried on by it;
- (b) it has the corporate power and capacity to enter into this Agreement and to do all acts and things as are required or contemplated hereunder to be done, observed and performed by it;
- (c) it has taken all necessary corporate action to authorize the execution, delivery and performance of this Agreement;
- (d) the entering into of this Agreement and the performance by the Debtor of its obligations hereunder does not and will not contravene, breach or result in any default under the articles, by-laws or other organizational documents of the Debtor or under any mortgage, lease, agreement or other legally binding instrument, license, permit or law to which the Debtor is a party or by which the Debtor or any of its properties or assets may be bound and will not result in or permit the acceleration of the maturity of any indebtedness, liability or obligation of the Debtor under any mortgage, lease, agreement or other legally binding instrument of or affecting the Debtor;
- (e) no authorization, consent or approval of, or filing with or notice to, any Person is required in connection with the execution, delivery or performance of this Agreement by the Debtor;
- (f) no (i) court, administrative, regulatory or similar proceeding (whether civil, quasi-criminal or criminal), (ii) arbitration or other dispute settlement procedure, (iii) investigation or enquiry by any government body, or (iv) any similar matter or proceeding (collectively "proceedings") against or involving the Debtor is current or, to the best of its knowledge, pending or threatened, which, if determined adversely to the

Debtor, would materially adversely affect its business, property, financial condition or prospects or its ability to perform any of the provisions of this Agreement; to the best of its knowledge, no event has occurred which might give rise to any proceedings and there is no judgment, decree, injunction, rule, award or order of any governmental body outstanding against the Debtor which has or may have a material adverse effect on its business, property, financial condition or prospects;

- (g) the Trustee has given Value to the Debtor;
- (h) the Debtor owns the Collateral free of all Liens, except for Permitted Liens;
- (i) except for certain rights to the Corporation Intellectual Property to which Technology Partnerships Canada ("TPC") may be entitled pursuant to a contribution agreement no. 730-481934 between the Parent and TPC dated March 27, 2002 (the "TPC Agreement") and except for certain rights to the Corporation Intellectual Property to which the Department of Natural Resources ("DNR") may be entitled pursuant to a contribution agreement no. EA0734-B7 and AD0336-96 between the Debtor and DNR dated June 19, 1996 (the "DNR Agreement") and except for certain rights to the Corporation Intellectual Property to which National Research Council of Canada ("NRC") may be entitled pursuant to a contribution agreement no. 401150 between the Debtor and NRC dated October 19, 2000 (the "IRAP Agreement"), either the Parent or the Debtor owns or has all of the necessary rights to use the Corporation Intellectual Property for the business as presently carried on by the Parent and the Debtor and the Parent and the Debtor have not licensed any rights from others material to the business of the Parent or the Debtor, the parties hereto acknowledging that the end user licenses obtained in the ordinary course of business shall not be treated as material. The representations, warranties and covenants in the foregoing sentence are made by the Debtor to the best of its knowledge with respect to, and solely in respect to, patent rights and trademark rights. With reference to the Registered Corporation Intellectual Property, all filings necessary to preserve the rights of the Parent and the Debtor have been made in respect of the pending patent applications, registered patents and pending trade-mark applications comprising the Registered Corporation Intellectual Property in the intellectual property offices in which such registrations and applications have respectively been filed as identified in Schedule B, and are in good standing. To the best of the knowledge of the Debtor, the business of the Parent and the Debtor, as currently carried on, does not infringe any Intellectual Property rights of any third party and there are no current pending or threatened proceedings, litigation or other adverse claims against the Parent or the Debtor affecting, or with respect to, any part of the Corporation Intellectual Property used by the Parent or the Debtor in the operation of its business, and, to the best of the knowledge of the Debtor, no person is, as of the date hereof, infringing upon the Corporation Intellectual Property;
- (j) except for certain rights to the Corporation Intellectual Property to which TPC may be entitled pursuant to the TPC Agreement and to which DNR may be entitled pursuant to the DNR Agreement and to which NRC may be entitled pursuant to the IRAP Agreement, to the best of the knowledge of the Debtor, either the Parent or the Debtor has the exclusive right to use, sell, license and dispose of all of the Corporation Intellectual Property that is material to the Parent's or the Debtor's business as presently carried on and, except for the patent license from the Debtor to the Parent dated March 25, 2002, has not granted any exclusive licence, conveyance or assignment in respect of the Corporation Intellectual Property, and recognizing that a patent is not the

right to practice an invention but a right to prevent others from practicing, to the best of the knowledge of the Debtor, there are currently no restrictions on the ability of the Parent or the Debtor, or any successor or assignee, to use and exploit all rights in the Corporation Intellectual Property in any way which would reasonably be expected to have a material adverse effect on the Parent's or the Debtor's business as presently carried on;

- (k) the Collateral does not include any Consumer Goods;
- (l) the Debtor does not have receivables or other amounts owing to it exceeding in aggregate \$1,000.00 from Persons located in any jurisdiction other than British Columbia and Ontario, except in the ordinary course of business and except as may be disclosed in writing after the date of this Agreement;
- (m) to the best of its knowledge, each Account, Chattel Paper and Instrument constituting Collateral is enforceable in accordance with its terms against the Person obligated to pay the same, and the amount represented by the Debtor to the Trustee from time to time as owing by each such Person or by all such Persons will be the correct amount actually and unconditionally owing by such Person or Persons, except for normal cash discounts where applicable;
- (n) with the exception of goods in transit and goods on lease or consignment, all tangible assets comprising the Collateral are located at the locations referred to in Schedule "A", and all fixtures or Goods about to become fixtures which comprise the Collateral are situate at one of such locations; and
- (o) the Debtor's sole place of business, or if the Debtor has more than one place of business, its chief executive office, is located at the place described in Schedule "A".

The representations, warranties and covenants made by the Debtor in Sections 3.1(i) and (j):

- (a) shall be made as of the date hereof and shall not extend thereafter; and
- (b) shall apply only to matters of which the Debtor or the Parent has actual knowledge without conducting any searches of public registries or investigating the independent developments of third parties.

ARTICLE 4 **AGREEMENTS OF THE DEBTOR**

4.1 General Agreements

The Debtor agrees, subject to Sections 4.6 and 4.7, that:

- (a) it shall not, without the prior written consent of the Debenture holders representing at least 50.1% of the principal amount of Debentures outstanding at such time, incur any Senior Indebtedness;
- (b) it shall pay or satisfy all Obligations when due;

- (c) it shall carry on and conduct its business in a proper and efficient manner and so as to protect and preserve the Collateral and shall keep, in accordance with generally accepted accounting principles, consistently applied, proper books of account for its business and accurate and complete records concerning Collateral, and shall mark any and all such records and Collateral at the Trustee's request (acting reasonably) so as to indicate the existence of the Security Interest;
- (d) it shall not enter into any transaction (including by way of reconstruction, reorganization, consolidation, amalgamation, merger, liquidation, transfer, sale or otherwise) whereby all or substantially all of its undertaking, property and assets would become the property of any other person, or, in the case of any such amalgamation, of the continuing corporation resulting therefrom without the prior written consent of the Debenture holders representing at least 50.1% of the principal amount of Debentures outstanding at such time;
- (e) it shall defend the Collateral against the claims and demands of any other Person;
- (f) it shall keep the Collateral in good order, condition and repair and shall not use the Collateral in violation of the provisions of this Agreement or any other agreement between the Debtor and the Trustee relating to Collateral or any policy insuring Collateral or any applicable statute, law, by-law, rule, regulation or ordinance;
- (g) it shall prevent any Collateral, except Inventory sold or leased as permitted hereby from being or becoming an Accession to property not covered by this Agreement;
- (h) it shall pay all taxes, rates, levies, assessments and other charges of every kind which may be lawfully levied, assessed or imposed against or in respect of it or Collateral as and when the same become due and payable;
- (i) it shall insure the Collateral for such periods, in such amounts, on such terms and against loss or damage by fire and such other risks as the Trustee shall reasonably direct, with loss payable to the Trustee and the Debtor, as their respective interests may appear, and shall pay all premiums therefor;
- (j) it shall notify the Trustee promptly of:
 - (i) any material change in the information contained in this Agreement or in the Schedules hereto relating to it including without limitation:
 - (A) any change in the name of the Debtor;
 - (B) any change in the place of business of the Debtor or, if the Debtor has more than one place of business, in the chief executive office of the Debtor; and
 - (C) any change in the location of the Collateral;
 - (ii) the details of any significant acquisition of Collateral other than Inventory in the ordinary course of business;

- (iii) the serial number (as prescribed by the regulations made under the PPSA for use in registrations under the PPSA), model year, make and model of any motor vehicle, trailer, mobile home, aircraft, airframe, boat, outboard motor for a boat or other Serial Number Goods (as such term is defined in the regulations made under the PPSA) at any time included in the Collateral which is held as Equipment, including in circumstances where the Debtor ceased holding the same as Inventory and began holding the same as Equipment;
 - (iv) the acquisition by it of receivables or other amounts owing to it exceeding \$1,000.00 in aggregate from Persons located in any jurisdiction other than British Columbia and Ontario, outside of the ordinary course of business;
 - (v) the details of any claims or litigation affecting it or the Collateral which, if determined adversely to the Debtor would materially adversely affect its business, property or prospects or its obligation to perform any of the provisions of this Agreement in any material respect;
 - (vi) any loss of or damage to the Collateral which would materially adversely affect its business, property or prospects or its obligation to perform any of the provisions of this Agreement in any material respect;
 - (vii) any default by any Person in payment or other performance of its obligations with respect to Collateral which would materially adversely affect the Debtor's business, property, or prospects or its obligation to perform any of the provisions of this Agreement in any material respect, and
 - (viii) the occurrence of any Event of Default,
- (k) it shall deliver to the Trustee from time to time promptly upon request:
- (i) any Documents of Title, Instruments, Securities and Chattel Paper constituting, representing or relating to the Collateral;
 - (ii) copies of all statements of accounts, bills, invoices and books of account relating to Accounts and all records, ledgers, reports, correspondence, schedules documents, statements, lists and other writings relating to the Collateral for the purpose of inspecting, auditing or copying the same;
 - (iii) all financial statements prepared by or for it regarding its business;
 - (iv) copies of all policies and certificates of insurance relating to Collateral; and
 - (v) such information concerning the Collateral, the Debtor and its business and affairs as the Trustee may reasonably request;
- (l) if requested by the Trustee (acting reasonably), it shall use all reasonable commercial efforts to obtain a written agreement from each of its landlords in favour of the Trustee and in form and substance satisfactory to the Trustee, whereby such landlord acknowledges the Security Interest and the right of the Trustee to enforce the Security Interest in priority to any claim of such landlord;

- (m) it shall not change its name without giving prior written notice to the Trustee of the new name and the date upon which such change of name is to take effect; and
- (n) it shall do, execute, acknowledge and deliver such financing statements and further assignments, transfers, documents, acts, matters and things (including further schedules to this Agreement) as may be reasonably requested by the Trustee or with respect to Collateral in order to give effect to this Agreement.

4.2 Restrictions on Dealings with Collateral

Except as provided in Section 4.3, the Debtor agrees that it shall not, without the prior consent in writing of the Trustee:

- (a) sell, assign, transfer, exchange, lease, consign or otherwise dispose of any Collateral;
- (b) move or transfer the Collateral from its present location; or
- (c) create, assume or suffer to exist any Lien upon the Collateral other than Permitted Liens.

No provision hereof shall be construed as a subordination or postponement of the Security Interest to or in favour of any other Lien, whether or not such Lien is a Permitted Lien.

4.3 Permitted Dealings with Collateral

The Debtor may at any time prior to the occurrence of an Event of Default, without the consent of the Trustee:

- (a) sell, assign, transfer, exchange, lease, consign or otherwise dispose of Inventory in the ordinary course of its business.
- (b) subject to Section 7.1, collect Accounts in the ordinary course of its business; and
- (c) subject to the provisions of the Trust Indenture, use Money available to the Debtor.

Nothing in this Agreement is intended to prevent the Debtor or the Parent from using and commercializing the Corporation Intellectual Property in order to carry on and further the business in the ordinary course prior to any Event of Default hereunder including:

- (a) making confidential disclosures of trade secrets comprising the Corporation Intellectual Property to third parties under written confidentiality agreements which oblige such third parties to keep such trade secrets confidential except where the recipient third party can show it:
 - (i) is already in the public domain at the time of disclosure or subsequently becomes publicly available without the breach of any obligation of confidentiality by the recipient;
 - (ii) is independently developed by the recipient as evidenced by written records;
 - (iii) is received by the recipient from a third party free to lawfully disclose such information;

- (iv) was lawfully in the recipient's possession prior to receipt from the Debtor or the Parent without an obligation of confidentiality; or
 - (v) is required to be disclosed by law, court order, court proceedings, or the rules or policies of any stock exchange or government or regulatory authority having jurisdiction;
- (b) entering into joint ventures, collaborations and research with third parties in order to develop, improve upon or commercialize any Corporation Intellectual Property; and
 - (c) licensing on a non-exclusive basis the Corporation Intellectual Property in order to carry on and further its business in the ordinary course, provided such licensing expressly sets out that no title is transferred.

4.4 Verification of Collateral

The Trustee shall have the right at any time and from time to time to verify the existence and state of the Collateral in any manner the Trustee may consider appropriate and the Debtor agrees to furnish all assistance and information and to perform all such acts as the Trustee may reasonably request in connection therewith and for such purpose to grant to the Trustee or its agents access to all places where Collateral may be located and to all premises occupied by the Debtor.

4.5 Expenses

The Debtor shall pay to the Trustee, on demand, all of the Trustee's reasonable costs, charges and expenses (including, without limitation, legal fees on a solicitor and his own client basis and Receiver's fees) in connection with the preparation, registration or amendment of this Agreement, the perfection or preservation of the Security Interest, the enforcement by any means of any of the provisions hereof or the exercise of any rights, powers or remedies hereunder, including, without limitation, all such costs, charges and expenses in connection with taking possession of Collateral, carrying on the Debtor's business, collecting the Debtor's accounts and taking custody of, preserving, repairing, processing, preparing for disposition and disposing of Collateral, together with interest on such costs, charges and expenses from the dates incurred to the date of payment.

4.6 Prosecution of Registered Corporation Intellectual Property

Notwithstanding any other terms to the contrary in this Agreement or any other written agreement relating thereto, the Debtor and/or the Parent will proceed with the prosecution of the pending patent applications and trade-mark applications identified in items 2 and 11 of Schedule B hereto, subject to the remaining terms of this Section. The parties hereto acknowledge that PCT/CA01/00101 is now at an end, that it has been entered into the National Phase before the Canadian Patent Office and the European Patent Office, and that no other National Phase entry applications are pending in respect of PCT/CA01/00101. Notwithstanding any other term to the contrary in this agreement or any other written agreement relating thereto, other than as set forth in this Section, the Debtor and the Parent shall have no other obligation to file or prosecute applications for registration of any patents, trade-marks or any other Intellectual Property, other than as set out in section 4.6 of the General Security Agreement between the Parent and the Trustee dated July 31, 2003. Any filing and prosecution of any other applications for registration of any Intellectual Property shall be at the absolute discretion of the Debtor and the Parent, as they consider affordable and appropriate.

4.7 Acknowledgment

Notwithstanding any other term to the contrary in this agreement, the parties hereto acknowledge and agree that any reduction, loss or deterioration of Corporation Intellectual Property or any part thereof arising from any information or materials being in or becoming public knowledge or entering the public domain due to the independent development of a third party or, notwithstanding all reasonably efforts by the Debtor, due to the wrongdoing or misappropriation committed by a third party, shall not result in a violation of this agreement, or constitute an Event of Default under Section 7.1(b) to 7.1(i) hereof.

ARTICLE 5
SECURITIES**5.1 Securities**

If the Collateral at any time includes Securities, the Debtor authorizes the Trustee to transfer the same or any part thereof into its own name or that of its nominee or nominees so that the Trustee or its nominee or nominees may appear as the sole owner of record thereof; provided that, until the occurrence of all Event of Default which is continuing, the Trustee shall deliver promptly to the Debtor all notices or other communications received by the Trustee or its nominee or nominees as such registered owner and, upon demand and receipt of payment of any necessary expenses thereof, shall grant to the Debtor or its nominee a proxy to vote and take all action with respect to such Securities. After the occurrence of all Event of Default which is continuing, the Debtor waives all rights to receive any notices or communications received by the Trustee or its nominee as such registered owner and agrees that no proxy granted by the Trustee to the Debtor or its nominee or nominees as aforesaid shall thereafter be effective. The Debtor shall be entitled to receive all dividends (whether paid or distributed in cash, Securities or other property) and interest declared and paid or distributed in respect of the Collateral, and such dividends and interest shall cease to be subject to the Security Interest if paid or distributed to the Debtor prior to the occurrence of all Event of Default which is continuing but not otherwise.

ARTICLE 6
COLLECTION OF DEBTS

6.1 Collection of Debts

After the occurrence of an Event of Default, the Trustee may give notice of the Security Interest to any Person obligated to pay any debt or liability constituting Collateral and may also direct such Person to make all payments on account of any such debt or liability to the Trustee. The Debtor acknowledges that any payments received by the Debtor from such Persons after an Event of Default which is continuing, whether before or after notification of the Security Interest to such Persons, shall be received and held by the Debtor in trust for the Trustee and shall be turned over to the Trustee upon request. After the occurrence of all Event of Default which is continuing, the Debtor agrees to deposit all Proceeds resulting from the disposition of Inventory into its account with a bank and a branch location approved by the Trustee from time to time or at any time and to inform such bank of the Security Interest and the trust established herein in favour of the Trustee attaching to the funds in such account.

ARTICLE 7
EVENTS OF DEFAULT

7.1 Events of Default

The happening of any of the following events or conditions shall constitute default hereunder and is herein referred to as an "Event of Default":

- (a) the occurrence of any of the Events of Default as set out in Article 7.1 of the Trust Indenture;
- (b) the nonpayment when due, whether by acceleration or otherwise, of any principal, interest or other amount forming part of the Obligations;
- (c) the failure of the Debtor to observe or perform any obligation, covenant, term, provision or condition contained in this Security Agreement, the Guarantee or any other agreement between the Debtor and the Trustee (whether now in existence or hereafter entered into);
- (d) if any Lien affecting the Collateral becomes enforceable against the Collateral;
- (e) if a decree or order of a court having jurisdiction in the premises is entered adjudging the Debtor a bankrupt or insolvent under the *Bankruptcy and Insolvency Act* (Canada) or any other bankruptcy, insolvency or analogous laws, or issuing sequestration or process of execution or distress or analogous process against, or against any substantial part of the property of, the Debtor, or appointment of a receiver of, or of any substantial part of the property of, the Debtor, or ordering the winding up or liquidation of its affairs, and any such decree or order continues unstayed and in effect for a period of 60 days;
- (f) if a resolution is passed for the winding up or liquidation of the Debtor or if the Debtor institutes proceedings to be adjudicated a bankrupt or insolvent, or consents to the institution of bankruptcy or insolvency proceedings against it under the *Bankruptcy and Insolvency Act* (Canada) or any other bankruptcy, insolvency or analogous laws, or consents to the filing of any such petition or to the appointment of a receiver of, or of a substantial part of, the property of the Debtor or makes a general assignment for the benefit of creditors, admits in writing its inability to pay its debt generally as they become

due, or ceases or threatens to cease to carry on business or makes or agrees to make a bulk sale of assets without complying with applicable law;

- (g) if any certificate, representation or warranty heretofore or hereafter furnished by or on behalf of the Debtor pursuant to or in connection with this Security Agreement or the Guarantee proves to have been false in any material respect at the time as of which the facts therein set forth were stated or certified;
- (h) if the Trustee in good faith and upon commercially reasonable grounds believes that the Collateral is or is about to be placed in jeopardy; and
- (i) the Debtor being in default in the payment or other performance of its obligations with respect to the Collateral or under any lease agreement which would materially adversely affect the Debtor's business, property, or prospects or its obligations to perform any of the provisions of this Agreement in any material respect.

7.2 Acceleration

Upon the occurrence of an Event of Default or at any time thereafter, the Trustee, in its sole discretion, may declare all or any part of the Obligations which is not by its terms payable on demand to be immediately due and payable, without demand or notice of any kind. The provisions of this Security Agreement are not intended in any way to and shall not affect any rights of the Trustee with respect to any Obligations which may now or hereafter be payable on demand.

ARTICLE 8 REMEDIES

8.1 Appointment of Receiver

Upon the occurrence of an Event of Default or at any time thereafter, the Trustee may appoint by instrument any Person, whether an officer or an employee of the Trustee or not to be a Receiver of Collateral and may remove any Receiver so appointed and appoint another in place of such Receiver in the same manner. Any such Receiver shall be deemed the agent of the Debtor and not of the Trustee for the purpose of (i) carrying on and managing the business and affairs of the Debtor, and (ii) establishing liability for all acts or omissions of the Receiver while acting as such, and the Trustee shall not be in any way responsible for any acts or omissions on the part of any such Receiver, its officers, employees and agents. The Debtor hereby irrevocably authorizes the Trustee to give instructions to the Receiver relating to the performance of its duties and to determine from time to time the Receiver's remuneration. To the extent permitted by law, the Debtor hereby irrevocably waives any right it may have now or in the future under any applicable law, including, without limitation the PPSA, to make application to a court for the removal, replacement or discharge of the Receiver or for directions on any matter relating to the duties of the Receiver (unless such duties are not being performed in a commercially reasonable manner) or in respect of the Receiver's accounts or remuneration or in respect of any other matter.

Subject to the provisions of the instrument appointing it, any such Receiver shall have all of the rights and remedies of a secured party under the PPSA and the power to take possession of Collateral, to use the Collateral in such manner as it considers appropriate, to preserve Collateral or its value in such manner as it considers appropriate, to carry on or concur in carrying on all or any part of the business of the Debtor and to sell, lease or otherwise dispose of or concur in selling, leasing or otherwise disposing of Collateral in such manner and of such terms, including terms for deferred payment, as it considers to be commercially reasonable. To facilitate the foregoing powers, any such Receiver may enter upon, use and

occupy all premises owned or occupied by the Debtor wherein Collateral may be situate to the exclusion of all others to the extent permitted by law, including the Debtor, maintain Collateral upon such premises, borrow money on a secured or unsecured basis, incur reasonable expenses in the exercise of the rights, powers and remedies set out in this Agreement and use Collateral directly in carrying on the Debtor's business or as security for loans or advances to enable it to carry on the Debtor's business or otherwise, as such Receiver shall, in its discretion, determine. In addition, the Receiver shall have the following rights, powers and remedies:

- (a) to make payments to Persons having prior rights or Liens on properties on which the Debtor may hold a Lien and to Persons having prior rights or Liens on the Collateral; and
- (b) to demand, commence, continue or defend proceedings in the name of the Trustee or of the Receiver or in the name of the Debtor for the purpose of protecting, seizing, collecting, realizing or obtaining possession or payment of the Collateral and to give effectual receipts and discharges therefor.

Except as may be otherwise directed by the Trustee, all Proceeds received from time to time by such Receiver in carrying out its appointment shall be received in trust for and paid over to the Trustee. Every such Receiver may, in the discretion of the Trustee be vested with all or any of the rights and powers of the Trustee.

8.2 Exercise of Remedies by Trustee

Upon the occurrence of an Event of Default which is continuing, the Trustee may, either directly or through its agents or nominees, exercise all the powers and rights available to a Receiver by virtue of Section 9.1. In addition to the rights granted in this Agreement and in any other agreement now or hereafter in effect between the Debtor and the Trustee and in addition to any other rights the Trustee may have at law or in equity or otherwise, the Trustee shall have, both before and after the occurrence of an Event of Default which is continuing, all rights and remedies of a secured party under the PPSA.

8.3 Possession of Collateral

Upon an Event of Default which is continuing, the Debtor acknowledges that the Trustee or any Receiver appointed by it may, subject to applicable law, take possession of Collateral wherever it may be located and the Debtor agrees upon request from the Trustee or any such Receiver to assemble and deliver possession of Collateral at such place or places as directed.

8.4 Remedies Not Exclusive

All rights, powers and remedies of the Trustee under this Agreement may be exercised separately or in combination and shall be in addition to, and not in substitution for, any other security now or hereafter held by the Trustee and any other rights, powers and remedies of the Trustee however created or arising. No single or partial exercise by the Trustee of any of the rights, powers and remedies under this Agreement or under any other security now or hereafter held by the Trustee shall preclude any other and further exercise of any other right, power or remedy pursuant to this Agreement or any other security or at law, in equity or otherwise. The Trustee shall at all times have the right to proceed against Collateral or any other security in such order and in such manner as it shall determine without waiving any rights, powers or remedies which the Trustee may have with respect to this Agreement or any other security or at law, in equity or otherwise. Subject to the applicable law, no delay or omission by the Trustee in exercising any right, power or remedy hereunder or otherwise shall operate as a waiver thereof or of any other right, power or remedy.

8.5 Debtor Liable for Deficiency

The Debtor shall remain liable to the Trustee for any deficiency after the proceeds of any sale, lease or disposition of Collateral are received by the Trustee.

8.6 Exclusion of Liability of Trustee and Receiver

Subject to applicable law, the Trustee shall not, nor shall any Receiver appointed by it, (i) be liable for any failure to exercise its rights, powers or remedies arising hereunder or otherwise, including without limitation, any failure to take possession of, collect, enforce, realize, sell, lease or otherwise dispose of, preserve or protect the Collateral, to carry on all or any part of the business of the Debtor relating to the Collateral or to take any steps or proceedings for any such purposes, and (ii) have any obligation to take any steps or proceedings to preserve rights against prior parties to or in respect of Collateral including, without limitation, any Instrument, Chattel Paper or Securities, whether or not in the Trustee's or the Receiver's possession, and neither the Trustee nor any Receiver appointed by it shall be liable for failure to do so. Subject to the foregoing, the Trustee shall use reasonable care in the custody and preservation of the Collateral in its possession.

8.7 Notice of Sale

Subject to applicable law, neither the Trustee nor any Receiver appointed by it shall be required to give the Debtor any notice of any sale, lease or other disposition of the Collateral, the date, time and place of any public sale of Collateral or the date after which any private disposition of Collateral is to be made.

**ARTICLE 9
APPLICATION OF PROCEEDS****9.1 Application of Proceeds**

Subject to applicable law, all Proceeds arising from the enforcement of the Security Interest shall be applied against the Obligations in accordance with Article 7 of the Trust Indenture.

**ARTICLE 10
GENERAL****10.1 Power of Attorney**

The Debtor hereby appoints the Trustee as the Debtor's attorney, with full power of substitution, in the name and on behalf of the Debtor, to execute, deliver and do all such acts, deeds, leases, documents, transfers, demands, conveyances, assignments, contracts, assurances, consents, financing statements and things as the Debtor has herein agreed to execute, deliver and do or as may be required by the Trustee or any Receiver to give effect to this Agreement or in the exercise of any rights, powers or remedies hereby conferred on the Trustee, and generally to use the name of the Debtor in the exercise of all or any of the rights, powers or remedies hereby conferred on the Trustee. This appointment, coupled with an interest, shall not be revoked by the insolvency, bankruptcy, dissolution, liquidation or other termination of the existence of the Debtor or for any other reason.

10.2 Set-Off

The Trustee may at any time and from time to time, without notice to the Debtor or to any other Person, set-off, appropriate and apply any and all deposits, general or special, matured or unmatured, held by or for the benefit of the Debtor with the Trustee and any other indebtedness and liability of the Trustee to the Debtor, matured or unmatured, against and on account of the Obligations when due, in such order of application as the Trustee may from time to time determine.

10.3 Dealings With Others

The Trustee may grant extensions of time and other indulgences, take and give up security, accept compositions, make settlements, grant releases and discharges and otherwise deal with the Debtor and sureties of the Debtor's obligations and, after the occurrence of an Event of Default which is continuing, with debtors of the Debtor or other Persons, as the Trustee sees fit, without prejudice to the liability of the Debtor to the Trustee or the rights, powers and remedies of the Trustee under this Agreement.

10.4 No Obligation to Advance

Nothing herein contained shall in any way obligate the Trustee to advance any funds, or otherwise make or continue to make any credit available, to the Debtor.

10.5 Perfection of Security

The Debtor authorizes the Trustee to file or to have filed such financing statements and other documents and do such acts, matters and things as the Trustee may consider appropriate to perfect and continue the Security Interest, to protect and preserve the interest of the Trustee in Collateral and to realize upon the Security Interest.

10.6 Continuing Security

This Security Agreement and the Security Interest created hereby are in addition to and not in substitution for any other security now or hereafter held by the Trustee and is, and is intended to be a continuing Security Agreement and Security Interest.

10.7 No Merger

This Security Agreement shall not merge in any subsequent security or be taken to be a substitute for any security of any nature whatsoever held by the Trustee from the Debtor. It is further agreed that the taking of this Security Agreement shall not operate as a merger of the remedies of the Trustee for payment, satisfaction or performance of the Obligations or of the remedies of the Trustee under any other agreement and notwithstanding this Security Agreement and anything herein contained the said remedies shall remain available and be capable of enforcement against the Debtor and all other persons liable in respect thereof in the same manner and to the same extent as if this Security Agreement had not been made.

10.8 Communication

Any notice or other communication, including a demand or a direction, required or permitted to be given hereunder shall be in writing and shall be given by prepaid first-class mail, by facsimile or other means of electronic communication or by hand-delivery as hereinafter provided. Any such notice or other communication, if mailed by prepaid first-class mail at any time other than during or within three (3)

Business Days prior to a general discontinuance of postal service due to strike, lockout or otherwise, shall be deemed to have been received on the fourth (4th) Business Day after the post-marked date thereof or if sent by facsimile or other means of electronic communication, shall be deemed to have been received on the Business Day following the sending, or if delivered by hand shall be deemed to have been received at the time it is delivered to the applicable address noted below either to the individual designated below or to a senior employee of the addressee at such address with responsibility for matters to which the information relates. Notice of change of address shall also be governed by this section. In the event of a general discontinuance of postal service due to strike, lock-out or otherwise, notices or other communications shall be delivered by hand or sent by facsimile or other means of electronic communication and shall be deemed to have been received in accordance with the foregoing. Notice and other communications shall be addressed as follows:

(a) if to the Trustee:

Valiant Trust Company
510, 550 - 6th Avenue S.W.
Calgary, Alberta T2P 0S2
Attention: Zinat Damji/Jenny Hart
Facsimile: (403) 267-6501

(b) if to the Debtor:

Azure Dynamics Inc.
4th Floor, 350 Bay Street
Toronto, Ontario M5H 2S6
Attention: President
Facsimile: (416) 367-9509

Notwithstanding the foregoing, if the PPSA requires that a notice or other communication be given in a specified manner, then any such notice or communication shall be given in such manner.

10.9 Successors and Assigns

This Agreement shall be binding on the Debtor and its successors and shall enure to the benefit of the Trustee and its successors and assigns. This Agreement shall be assignable by the Trustee free of any set-off, counter-claim or equities between the Debtor and the Trustee, and the Debtor shall not assert against an assignee of the Trustee any claim or defense that the Debtor has against the Trustee.

10.10 Copy Received

The Debtor hereby acknowledges receipt of a copy of this Agreement.

10.11 Applicable Law


This Agreement shall be construed in accordance with the laws of the Province of Alberta and shall be treated in all respects as Alberta contracts.

Copy of Financing Statements

The Debtor hereby waives any and all rights the Debtor has or may have to receive a copy of any financing statement or financing change statement filed by or for the Trustee or any verification statement in respect thereof.

IN WITNESS WHEREOF the Debtor has executed this Agreement as of the date hereinabove written.

Witnessed by:


Name: STEVE GLASER

) AZURE DYNAMICS INC.

) By: D. Campbell Deacon
) D. Campbell Deacon
) President

) I have authority to bind the Corporation

) Date: July 31, 2003

SCHEDULE "A"
to the General Security Agreement dated July 31, 2003
by Azure Dynamics Inc. in favour of Valiant Trust Company

COLLATERAL - LOCATIONS

A. Chief Executive Office

Azure Dynamics Inc.
4th Floor, 350 Bay Street
Toronto, Ontario
M5H 2S6

B. Locations of Collateral

Azure Dynamics Inc.
4th Floor, 350 Bay Street
Toronto, Ontario
M5H 2S6

Azure Dynamics Inc.
3650 Westbrook Mall
Vancouver, British Columbia
V6S 2L2

SCHEDULE "B"

to the General Security Agreement dated July 31, 2003
by Azure Dynamics Inc. in favour of Valiant Trust Company

Azure Dynamics Inc. Intellectual Property
Patents, Patent Applications Filed, and unregistered documented intellectual property

Reference Number	Title	Status	Description	Assignee
1 ⁽¹⁾	A Control System For A Hybrid Vehicle	<i>Patent Awarded:</i> US Patent # 5898282 Canadian Patent # 2,626,310 Expires: Aug 7, 2017	A hybrid vehicle control system that actively monitors sensor data and enters this into an onboard simulation model. The system is then optimised based on the model output whereby the system adapts the vehicle operations to any drive cycle.	Azure Dynamics Inc.
2	Method And Apparatus For Adaptive Hybrid Vehicle Control	<i>Patent Awarded:</i> US Patent # 6242873 Expires: Jan 31, 2020 <i>Applications:</i> Canadian application # 2,397,074 PCT/CA01/00101, international phase now completed, nationalization as Canadian Patent Application No. 2,397,074 and European Patent Application No. 01902208.6	A hybrid vehicle control system utilizing a simulation model that is validated during each control interval. The operating data is used to predict the next drive cycle and its energy requirements. It also adapts to changing driving conditions and component parameter changes.	Azure Dynamics Inc.

Trade Marks and Trade Mark Applications Filed

Reference Number	Title	Status	Description	Applicant
11	AZURE DYNAMICS & Design	Canadian Trade Mark granted March 24, 2003 # 1099300 US application # 76245365	Words AZURE DYNAMICS and design symbol in classes 9, 12 and 42 (classes are only applicable to the U.S. case)	Azure Dynamics Inc.
12	SMART ENERGY MANAGEMENT	US application # 76402142 Canadian application # 1,121,144 European Community Trade Mark application # 2680862	Words SMART ENERGY MANAGEMENT in classes 9, 12 and 42 (classes are only applicable to the U.S. case)	Azure Dynamics Inc.

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Notes:

- (1) In accordance with a contribution agreement, "DNR" Agreement No. AB0734-D7 and amendment No. AD0336-96, between the Department of Natural Resources ("DNR") and Azure Dynamics Inc., as proponent, dated January 19, 1996 (amended January 24, 1997), DNR has, or could have, rights to this intellectual property in certain circumstances of default as more fully defined in the DNR Agreement. This agreement provides that if the proponent elects not to retain ownership of the intellectual property developed during the course of this project, the proponent will notify the Minister of such election and shall, if the Minister so requires, assign and transfer such intellectual property to Canada, whereupon Canada will grant to the proponent a non-exclusive, royalty free licence to use such intellectual property solely for internal purposes, if requested by the proponent. This agreement prohibits assignment of the agreement without the prior written consent of the Minister. Upon certain events, including bankruptcy, assignment to creditors, winding up etc, the Minister may request that the proponent assign all rights in such intellectual property to the Minister.
- (2) In accordance with a contribution agreement, "TPC" Agreement No. 730-481934, between Technology Partnerships Canada ("TPC") and Azure Dynamics Corporation, as proponent, dated March 27, 2002, TPC has, or could have, rights in this intellectual property in certain circumstances of default as more fully defined in the TPC General Conditions of said agreement. This agreement requires title of the intellectual property to remain vested exclusively with the Company unless written consent of the Minister is obtained. The agreement prohibits assignment of the agreement without the prior written consent of the Minister. In certain "events of default" (including bankruptcy or dissolution of the proponent), the Minister may direct the proponent to transfer title to the Minister of all of the proponent's rights in this property, to the extent it was developed during the course of the project to which this agreement relates. The agreement provides for good faith negotiation to settle disputes and for mediation, if necessary.

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