

04-30-2003

Form PTO-1594 (Rev. 03/01) OMB No. 0651-0027 (exp. 5/31/2002)



U.S. DEPARTMENT OF COMMERCE U.S. Patent and Trademark Office

Tab settings

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To the Honorable Commissioner of Patents and Trademarks: Please record the attached original documents or copy thereof.

1. Name of conveying party(ies): Advanced H20, Inc. 41-78 US
Individual(s) Association
General Partnership Limited Partnership
Corporation-State
Other
Additional name(s) of conveying party(ies) attached? Yes No

2. Name and address of receiving party(ies)
Name: St. Cloud Capital Partners, L.P.
Internal Address:
Street Address: 10866 Wilshire Blvd, Suite 145
City: Los Angeles State: CA Zip: 90024
Individual(s) citizenship
Association
General Partnership
Limited Partnership Delaware
Corporation-State
Other
If assignee is not domiciled in the United States, a domestic representative designation is attached: Yes No
(Designations must be a separate document from assignment)
Additional name(s) & address(es) attached? Yes No

3. Nature of conveyance:
Assignment Merger
Security Agreement Change of Name
Other
Execution Date: April 18, 2003

4. Application number(s) or registration number(s):
A. Trademark Application No.(s) 76/394,045
Additional number(s) attached Yes No

B. Trademark Registration No.(s) 2,505,528
2,640,164
Additional number(s) attached Yes No

5. Name and address of party to whom correspondence concerning document should be mailed:
Name: Rebecca Kwok, Esq.
Internal Address: Latham & Watkins LLP
Street Address: 633 West Fifth Street Suite 4000
City: Los Angeles State: CA Zip: 90071

6. Total number of applications and registrations involved: 3
7. Total fee (37 CFR 3.41) \$ 90.00
Enclosed
Authorized to be charged to deposit account

8. Deposit account number:

OFFICE OF PUBLIC RECORDS
2003 APR 28 AM 3:21
FINANCE SECTION

9. Signature. Rachel Pinto Signature Date April 22, 2003
Name of Person Signing Signature Date

04/29/2003 BYRNE 0000025 76394045

Total number of pages including cover sheet, attachments, and document: 36

40.00 documents to be recorded with required cover sheet information to:
56.00 Commissioner of Patent & Trademarks, Box Assignments
Washington, D.C. 20231

01 FC:8521
02 FC:8522

This Security Agreement is subject to the terms of the Subordination Agreement dated as of April 18, 2003, by and among St. Cloud Capital Partners, L.P., a Delaware limited partnership, Seacoast Capital Partners II, LP, a Delaware limited partnership, and Comerica Bank-California.

SECURITY AGREEMENT

This **SECURITY AGREEMENT** (this "**Agreement**") is dated as of April 18, 2003 and entered into by and between **ADVANCED H2O, INC.** ("**Grantor**"), and **ST. CLOUD CAPITAL PARTNERS, L.P.**, a Delaware limited partnership, as Agent for the benefit of the Lenders ("**Secured Party**"). The "**Lenders**" shall mean, collectively, **ST. CLOUD CAPITAL PARTNERS, L.P.**, a Delaware limited partnership ("**St. Cloud**"), and **SEACOAST CAPITAL PARTNERS II, LP**, a Delaware limited partnership ("**Seacoast**"), and any other "**Payees**" under the Notes (as defined below).

PRELIMINARY STATEMENTS

- A. Pursuant to that certain Securities Purchase Agreement dated as of the date hereof, between Grantor and the Lenders, as amended, modified or supplemented from time to time (the "**Securities Purchase Agreement**"; the terms defined therein and capitalized, but not otherwise defined herein being used herein as therein defined), St. Cloud has purchased that certain 12% Subordinated Note in the principal amount of \$1,750,000 (the "**St. Cloud Note**") and Seacoast has purchased that certain 12% Subordinated Note in the principal amount of \$1,250,000 (the "**Seacoast Note**" and together with the St. Cloud Note, the "**Notes**").
- B. It is a condition precedent to the purchase of the Notes by the Lenders under the Securities Purchase Agreement that Grantor shall have granted the security interests and undertaken the obligations contemplated by this Agreement.

NOW, THEREFORE, in consideration of the premises and in order to induce the Lenders to purchase the Note and enter into the Securities Purchase Agreement, and for other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, Grantor hereby agrees with Secured Party as follows:

SECTION 1. Grant of Security.

Grantor hereby assigns to Secured Party, for the benefit of the Lenders, and hereby grants to Secured Party, for the ratable benefit of the Lenders, a security interest in, all of Grantor's right, title and interest in and to the following, in each case whether now or

hereafter existing or in which Grantor now has or hereafter acquires an interest and wherever the same may be located (the "**Collateral**");

(a) all equipment in all of its forms, all parts thereof and all accessions thereto (any and all such equipment, parts and accessions being the "**Equipment**");

(b) all inventory in all of its forms, including but not limited to (i) all goods held by Grantor for sale or lease or to be furnished under contracts of service or so leased or furnished, (ii) all raw materials, work in process, finished goods, and materials used or consumed in the manufacture, packing, shipping, advertising, selling, leasing, furnishing or production of such inventory or otherwise used or consumed in Grantor's business, (iii) all goods in which Grantor has an interest in mass or a joint or other interest or right of any kind, and (iv) all goods which are returned to or repossessed by Grantor) and all accessions thereto and products thereof (collectively the "**Inventory**") and all negotiable and non-negotiable documents of title (including without limitation warehouse receipts, dock receipts and bills of lading) issued by any Person covering any Inventory (any such negotiable document of title being a "**Negotiable Document of Title**");

(c) all accounts, contract rights, chattel paper (including tangible and electronic chattel paper), documents, instruments, general intangibles and other rights and obligations of any kind owned by or owing to Grantor and all rights in, to and under all security agreements, leases and other contracts securing or otherwise relating to any such accounts, contract rights, chattel paper, documents, instruments, general intangibles or other obligations (any and all such accounts, contract rights, chattel paper, documents, instruments, general intangibles and other obligations being the "**Accounts**", and any and all such security agreements, leases and other contracts being the "**Related Contracts**");

(d) all deposit accounts ("**Deposit Accounts**"), together with (i) all amounts on deposit from time to time in such deposit accounts; and (ii) all interest, cash, instruments, securities and other property from time to time received, receivable or otherwise distributed in respect of or in exchange for any or all of the foregoing;

(e) the "**Securities Collateral**", which term means:

(i) the shares of stock, limited partnership interests, interests in joint ventures, limited liability company interests and all other equity interests in a Person (the "**Pledged Shares**") from time to time acquired by Grantor in any manner and the certificates or other instruments representing such Pledged Shares and any interest of Grantor in the entries on the books of any securities intermediary pertaining to such Pledged Shares, and all dividends, cash, warrants, rights, instruments and other property or proceeds from time to time received, receivable or otherwise distributed in respect of or in exchange for any or all of such Pledged Shares; provided, that if the issuer of any of such Pledged Shares is a controlled foreign corporation (used hereinafter as such term is defined in Section 957(a) or a successor provision of the Internal Revenue Code of 1986, as amended from time to time), the Pledged Shares shall not include any shares of stock of such issuer in excess of the number of shares of such issuer possessing up to but not exceeding 65% of the voting

power of all classes of capital stock entitled to vote of such issuer, and all dividends, cash warrants, rights, instruments and other property or proceeds from time to time received, receivable or otherwise distributed in respect of or in exchange for any or all of such Pledged Shares; and

(ii) all shares of, and all securities convertible into and warrants, options and other rights to purchase or otherwise acquire, stock or other equity interests of any Person that, after the date of this Agreement, becomes, as a result of any occurrence, a direct Subsidiary of Grantor (which shares shall be deemed to be part of the Pledged Shares), the certificates or other instruments representing such shares, securities, warrants, options or other rights and any interest of Grantor in the entries on the books of any securities intermediary pertaining to such shares (subject to the proviso to Section 1(e)(i) with respect to shares of a foreign controlled corporation), and all dividends, cash, warrants, rights, instruments and other property or proceeds from time to time received, receivable or otherwise distributed in respect of or in exchange for any or all of such shares, securities, warrants, options or other rights;

(f) the “**Intellectual Property Collateral**”, which term means:

(i) all rights, title and interest (including rights acquired pursuant to a license or otherwise but only to the extent permitted by agreements governing such license or other use) in and to all trademarks, service marks, designs, logos, indicia, tradenames, trade dress, corporate names, company names, business names, fictitious business names, trade styles and/or other source and/or business identifiers and applications pertaining thereto, owned by Grantor, or hereafter adopted and used, in its business (including, without limitation, the trademarks specifically identified in **Schedule 1(f)(i)**, as the same may be amended pursuant hereto from time to time) (collectively, the “**Trademarks**”), all registrations that have been or may hereafter be issued or applied for thereon in the United States and any state thereof and in foreign countries (including, without limitation, the registrations and applications specifically identified in **Schedule 1(f)(i)**, as the same may be amended pursuant hereto from time to time) (the “**Trademark Registrations**”), all common law and other rights (but in no event any of the obligations) in and to the Trademarks in the United States and any state thereof and in foreign countries (the “**Trademark Rights**”), and all goodwill of Grantor’s business symbolized by the Trademarks and associated therewith (the “**Associated Goodwill**”):

(ii) all rights, title and interest (including rights acquired pursuant to a license or otherwise but only to the extent permitted by agreements governing such license or other use) in and to all patents and patent applications and rights and interests in patents and patent applications under any domestic or foreign law that are presently, or in the future may be, owned or held by Grantor and all patents and patent applications and rights, title and interests in patents and patent applications under any domestic or foreign law that are presently, or in the future may be, owned by Grantor in whole or in part (including, without limitation, the patents and patent applications listed in **Schedule 1(f)(ii)**, as the same may be amended pursuant hereto from time to

time), all rights (but not obligations) corresponding thereto (including, without limitation, the right (but not the obligation), exercisable only upon the occurrence and during the continuation of an Event of Default, to sue for past, present and future infringements in the name of Grantor or in the name of Secured Party), and all re-issues, divisions, continuations, renewals, extensions and continuations-in-part thereof (all of the foregoing being collectively referred to as the "**Patents**"); it being understood that the rights and interests included in the Intellectual Property Collateral hereby shall include, without limitation, all rights and interests pursuant to licensing or other contracts in favor of Grantor pertaining to patent applications and patents presently or in the future owned or used by third parties but, in the case of third parties which are not affiliates of Grantor, only to the extent permitted by such licensing or other contracts and, if not so permitted, only with the consent of such third parties; and

(iii) all rights, title and interest (including rights acquired pursuant to a license or otherwise but only to the extent permitted by agreements governing such license or other use) under copyright in various published and unpublished works of authorship including, without limitation, computer programs, computer data bases, other computer software, layouts, trade dress, drawings, designs, writings, and formulas owned by Grantor (including, without limitation, the works listed on **Schedule 1(f)(iii)**, as the same may be amended pursuant hereto from time to time) (collectively, the "**Copyrights**"), all copyright registrations issued to Grantor and applications for copyright registration that have been or may hereafter be issued or applied for thereon by Grantor in the United States and any state thereof and in foreign countries (including, without limitation, the registrations listed on **Schedule 1(f)(iii)**, as the same may be amended pursuant hereto from time to time) (collectively, the "**Copyright Registrations**"), all common law and other rights in and to the Copyrights in the United States and any state thereof and in foreign countries including all copyright licenses (but with respect to such copyright licenses, only to the extent permitted by such licensing arrangements) (the "**Copyright Rights**"), including, without limitation, each of the Copyrights, rights, titles and interests in and to the Copyrights and works protectable by copyright, which are presently, or in the future may be, owned, created (as a work for hire for the benefit of Grantor), authored (as a work for hire for the benefit of Grantor), or acquired by Grantor, in whole or in part, and all Copyright Rights with respect thereto and all Copyright Registrations therefor, heretofore or hereafter granted or applied for, and all renewals and extensions thereof, throughout the world, including all proceeds thereof (such as, by way of example and not by limitation, license royalties and proceeds of infringement suits), the right (but not the obligation) to renew and extend such Copyright Registrations and Copyright Rights and to register works protectable by copyright and the right (but not the obligation) to sue for past, present and future infringements of the Copyrights and Copyright Rights;

(g) all information used or useful or arising from the business including all goodwill, trade secrets, trade secret rights, know-how, customer lists, processes of production, ideas, confidential business information, techniques, processes, formulas, and all other proprietary information;

(h) to the extent not included in any other paragraph of this Section 1, all other general intangibles (including without limitation tax refunds, payment intangibles, rights to payment or performance, *choses in action* and judgments taken on any rights or claims included in the Collateral), all other investment property, all commercial tort claims (including, without limitation, those that may be added to **Schedule 1(h)** pursuant to Section 5(a)(1)(viii)), all supporting obligations, all letter of credit rights, all software, all other goods, and all other personal property of every type and nature;

(i) all plant fixtures, business fixtures and other fixtures and storage and office facilities, and all accessions thereto and products thereof;

(j) all books, records, ledger cards, files, correspondence, computer programs, tapes, disks and related data processing software that at any time evidence or contain information relating to any of the Collateral or are otherwise necessary or helpful in the collection thereof or realization thereupon; and

(k) all proceeds, products, rents and profits of or from any and all of the foregoing Collateral and, to the extent not otherwise included, all payments under insurance (whether or not Secured Party is the loss payee thereof), or any indemnity, warranty or guaranty, payable by reason of loss or damage to or otherwise with respect to any of the foregoing Collateral. For purposes of this Agreement, the term "**proceeds**" includes whatever is receivable or received when Collateral or proceeds are sold, exchanged, collected or otherwise disposed of, whether such disposition is voluntary or involuntary.

Notwithstanding anything herein to the contrary, in no event shall the Collateral include, and no Grantor shall be deemed to have granted a security interest in (i) any of Grantor's rights or interests in any license, contract or agreement to which Grantor is a party or any of its rights or interests thereunder to the extent, but only to the extent, that such a grant would, under the terms of such license, contract or agreement or otherwise, result in a breach of the terms of, or constitute a default under any license, contract or agreement to which Grantor is a party (other than to the extent that any such term would be rendered ineffective pursuant to Sections 9-406 or 9-408 of the Uniform Commercial Code of any relevant jurisdiction (the "UCC") or any other applicable law (including the Bankruptcy Code) or principles of equity); provided, that immediately upon the ineffectiveness, lapse or termination of any such provision, the Collateral shall include, and Grantor shall be deemed to have granted a security interest in, all such rights and interests as if such provision had never been in effect, or (ii) any real property leasehold, unless Grantor has executed a leasehold mortgage or leasehold deed of trust covering such real property leasehold. Further, the security interest granted by Grantor to Secured Party pursuant to this **Section 1** in customer lists and contracts with vendors, suppliers and customers related solely to Grantor's Cascade Clear water business and the "CASCADE CLEAR" trademark is granted to Secured Party solely for the benefit of St. Cloud, and not for the benefit of any other Lender.

SECTION 2. Security for Obligations.

(a) This Agreement secures, and the Collateral assigned by Grantor is collateral security for, the prompt payment or performance in full when due, whether at stated

maturity, by required prepayment, declaration, acceleration, demand or otherwise (including without limitation, the payment of amounts that would become due but for the operation of the automatic stay under Section 362(a) of the Bankruptcy Code, 11 U.S.C. §362(a)), of all Secured Obligations with respect to Grantor. "**Secured Obligations**" means all obligations and liabilities of every nature of Grantor now or hereafter existing under or arising out of or in connection with the Notes, together with all extensions or renewals thereof, whether for principal, interest (including without limitation interest that, but for the filing of a petition in bankruptcy with respect to Grantor, would accrue on such obligations, whether or not a claim is allowed against Grantor for such interest in the related bankruptcy proceeding), fees, expenses, indemnities or otherwise, whether voluntary or involuntary, direct or indirect, absolute or contingent, liquidated or unliquidated, whether or not jointly owed with others, and whether or not from time to time decreased or extinguished and later increased, created or incurred, and all or any portion of such obligations or liabilities that are paid, to the extent all or any part of such payment is avoided or recovered directly or indirectly from any Lender as a preference, fraudulent transfer or otherwise, and all obligations of every nature of Grantor now or hereafter existing under this Agreement.

SECTION 3. Grantor Remains Liable.

Anything contained herein to the contrary notwithstanding, (a) Grantor shall remain liable under any contracts and agreements included in the Collateral, to the extent set forth therein, to perform all of its duties and obligations thereunder to the same extent as if this Agreement had not been executed, (b) the exercise by Secured Party of any of its rights hereunder shall not release Grantor from any of its duties or obligations under the contracts and agreements included in the Collateral, and (c) Secured Party shall not have any obligation or liability under any contracts and agreements included in the Collateral by reason of this Agreement, nor shall Secured Party be obligated to perform any of the obligations or duties of Grantor thereunder or to take any action to collect or enforce any claim for payment assigned hereunder.

SECTION 4. Representations and Warranties.

Grantor represents and warrants as follows:

(a) **Ownership of Collateral.** Except for the security interest created by this Agreement, the security interest created in favor of Senior Lender under the Senior Credit Facility (each term as defined in the Securities Purchase Agreement), the security interest in favor of Secured Party for the benefit of the Lenders securing Grantor's obligations under the Notes, security interests, Liens and encumbrances permitted pursuant to Section 7.4.9 of the Securities Purchase Agreement and those listed on Schedules 5.5.1 and 5.5.2 to the Securities Purchase Agreement (the "**Permitted Liens**"), Grantor owns the Collateral free and clear of any lien, mortgage, pledge, assignment, security interest, charge or encumbrance of any kind (or any option, trust or other preferential arrangement having the practical effect of any of the foregoing) (collectively, "**Lien**"). Except for filings as may have been filed in favor of Secured Party for the benefit of the Lenders relating to this Agreement and the Notes, and for filings in favor of Senior Lender under the Senior Credit Facility and filings related to the

Permitted Liens, no effective financing statement or other instrument similar in effect covering all or any part of the Collateral is on file in any filing or recording office.

(b) **Locations of Equipment and Inventory.** All of the Equipment and Inventory is, as of the date hereof, located at the places specified in **Schedule 4(b)**, except for Inventory which, in the ordinary course of business, is in transit either (i) from a supplier to Grantor, (ii) between the locations specified in **Schedule 4(b)**, or (iii) to customers of Grantor.

(c) **Negotiable Documents of Title.** Except as set forth on **Schedule 4(c)**, no Negotiable Documents of Title are outstanding with respect to any of the Inventory.

(d) **Office Locations.** The chief place of business, the chief executive office and the office where Grantor keeps its records regarding the Accounts and all originals of all chattel paper that evidence Accounts are located at the locations set forth on **Schedule 4(d)**.

(e) **Names.**

(i) Grantor (or predecessor by merger or otherwise of Grantor) has not had a different name from the name of Grantor listed on the signature page hereof except as listed on **Schedule 4(e)(i)**.

(ii) **Schedule 4(e)(ii)** identifies Grantor's name as of the date hereof as it appears in official filings in the jurisdiction of its incorporation or other organization, the type of entity of Grantor (including corporation, partnership, limited partnership or limited liability company), organizational identification number issued by Grantor's jurisdiction of incorporation or organization or a statement that no such number has been issued and the jurisdiction in which Grantor is incorporated or organized. Grantor has only one jurisdiction of incorporation or organization and has not reincorporated or reorganized itself under the laws of any other jurisdiction.

(f) **Delivery of Certain Collateral.** Except to the extent such Collateral has been delivered to the Senior Lender, all certificates or instruments (excluding checks) evidencing, comprising or representing the Collateral have been delivered to Secured Party duly endorsed or accompanied by duly executed instruments of transfer or assignment in blank.

(g) **Intellectual Property Collateral.**

(i) a true and complete list of all Trademark Registrations and Trademark applications owned, held (whether pursuant to a license or otherwise) or used by Grantor, in whole or in part, is set forth in **Schedule 1(f)(i)**;

(ii) a true and complete list of all Patents owned, held (whether pursuant to a license or otherwise) or used by Grantor, in whole or in part, is set forth in **Schedule 1(f)(ii)**;

(iii) a true and complete list of all Copyright Registrations and applications for Copyright Registrations held (whether pursuant to a license or otherwise) by Grantor, in whole or in part, is set forth in **Schedule 1(f)(iii)**;

(iv) Grantor is not aware of any pending or threatened claim by any third party that any of the Intellectual Property Collateral owned, held or used by Grantor is invalid or unenforceable; and

(v) except for the security interest created in favor of Senior Lender under the Senior Credit Facility and the Permitted Liens, no effective security interest or other Lien covering all or any part of the Intellectual Property Collateral is on file in the United States Patent and Trademark Office or the United States Copyright Office.

(h) Perfection. The security interests in the Collateral granted to Secured Party hereunder constitute valid security interests in the Collateral, securing the payment of the Secured Obligations. Upon the filing of a UCC financing statement with the Washington State Department of Licensing naming Grantor as "debtor", naming Secured Party as "secured party" and describing the Collateral, the security interests in the Collateral granted to Secured Party will constitute perfected security interests therein prior to other liens on the Collateral other than Permitted Liens, to the extent a security interest in the Collateral can be perfected by the filing of a financing statement under the UCC of the State of Washington. In the case of the Intellectual Property Collateral the recording of this Agreement in United States Patent and Trademark Office or the United States Copyright Office, as applicable and in the case of Equipment which is covered by a certificate of title, the filing with the registrar of motor vehicles or other appropriate authority in the applicable jurisdiction of an application requesting the notation of the security interest created hereunder on such certificate of title, the security interests in such Intellectual Property Collateral and Equipment granted to Secured Party will constitute perfected security interests therein prior to other liens on the Collateral other than Permitted Liens. Secured Party acknowledges that possession and/or control of certain Collateral may be limited (A) to the extent that such Collateral has been delivered to the Senior Lender and (B) by the terms of that certain Subordination Agreement, dated as of the date hereof, by and between Comerica Bank-California and the Lenders (the "**Subordination Agreement**") (or, if applicable, by the terms of a Future Subordination Agreement (as defined in Section 20) that may be entered into by the Lenders).

SECTION 5. Further Assurances.

(a) **Generally.** (1) Grantor agrees that from time to time, at Grantor's expense, it will promptly execute and deliver all further instruments and documents (provided that requests for additional documents must be reasonable), and take all further action, that may be necessary or desirable, or that Secured Party may request, in order to perfect and protect any security interest granted or purported to be granted hereby or to enable Secured Party to exercise and enforce its rights and remedies hereunder with respect to any Collateral. Without limiting the generality of the foregoing, Grantor will: (i) at the request of Secured Party, mark conspicuously each item of chattel paper (or take such other actions necessary to grant Secured Party control of electronic chattel paper as contemplated by the UCC) included

in the Accounts, each Related Contract and, at the request of Secured Party, each of its records pertaining to the Collateral, with a legend, in form and substance satisfactory to Secured Party, indicating that such Collateral is subject to the security interest granted hereby, (ii) at the request of Secured Party as long as an Event of Default shall have occurred and be continuing, deliver and pledge to Secured Party hereunder all promissory notes and other instruments (including checks) and all original counterparts of chattel paper constituting Collateral, duly endorsed and accompanied by duly executed instruments of transfer or assignment, all in form and substance satisfactory to Secured Party, (iii) execute and file such financing or continuation statements, or amendments thereto, and such other instruments or notices, as may be necessary or desirable, or as Secured Party may request, in order to perfect and preserve the security interests granted or purported to be granted hereby, (iv) furnish to Secured Party from time to time statements and schedules further identifying and describing the Collateral and such other reports in connection with the Collateral as Secured Party may reasonably request, all in reasonable detail, (v) promptly after the acquisition by Grantor of any item of Equipment which is covered by a certificate of title under a statute of any jurisdiction under the law of which indication of a security interest on such certificate is required as a condition of perfection thereof, execute and file with the registrar of motor vehicles or other appropriate authority in such jurisdiction an application or other document requesting the notation or other indication of the security interest created hereunder on such certificate of title, (vi) at the request of Secured Party, obtain control agreements in form and substance satisfactory to Secured Party with each bank or financial institution holding a Deposit Account; (vii) at the request of Secured Party, obtain control letters in form and substance satisfactory to Secured Party from issuers of uncertificated securities, securities intermediary or commodities intermediaries, issuing or holding financial assets or commodities of Grantor, (viii) promptly update **Schedule 1(h)** with any new commercial tort claim obtained by it and promptly update **Schedule 4(c)** with any additional Negotiable Documents of Title with respect to any of the Inventory; (ix) at the request of Secured Party, promptly upon becoming a beneficiary of a letter of credit, enter into a triparty agreement with the issuer or confirming bank with respect to letter of credit rights, directing all payments thereunder be made to Secured Party; (x) within 30 days after the end of each calendar quarter, deliver to Secured Party copies of all such applications or other documents filed during such calendar quarter and copies of all such certificates of title issued during such calendar quarter indicating the security interest created hereunder in the items of Equipment covered thereby, (xi) at any reasonable time, upon request by Secured Party, exhibit the Collateral to and allow inspection of the Collateral by Secured Party, or persons designated by Secured Party, (xii) at Secured Party's request, appear in and defend any action or proceeding that may affect Grantor's title to or Secured Party's security interest in all or any part of the Collateral, and (xiii) use commercially reasonable efforts to obtain any necessary consents of third parties to the assignment and perfection of a security interest to Secured Party with respect to any Collateral. Grantor hereby authorizes Secured Party to file one or more financing or continuation statements, and amendments thereto, relative to all or any part of the Collateral without the signature of Grantor. Grantor agrees that a carbon, photographic or other reproduction of this Agreement (together with any amendments and supplements thereto) or of a financing statement authorized by Section 5(a)(2) below shall be sufficient as a financing statement and may be filed as a financing statement in any and all jurisdictions. Additionally, Grantor agrees that this Agreement (together with any amendments and

supplements thereto) may be filed or recorded in the United States Patent and Trademark Office and in the United States Copyright Office.

(2) Grantor irrevocably authorizes Secured Party to file financing statements and other filing or recording documents with respect to the Collateral (including any amendments thereto, or continuation or termination statements thereof), without the signature or other authorization of Grantor, in such form and in such offices as Secured Party reasonably determines appropriate to perfect or maintain the perfection of its security interest hereunder. Grantor acknowledges and agrees that it is not authorized to, and will not, file financing statements or other filing or recording documents with respect to the Collateral (including any amendments thereto, or continuation or termination statements thereof), without the express prior written approval by Secured Party, consenting to the form and substance of such filing or recording document; provided, however, that these provisions shall not prohibit Grantor from filing termination statements at such time as all sums and/or obligations secured hereby have been indefeasibly paid in full or otherwise terminated by the Secured Party and the Lenders. Any initial financing statements, continuations and amendments thereto (A) may indicate the Collateral (1) as all assets of Grantor or words of similar effect, regardless of whether any particular asset comprised in the Collateral falls within the scope of Article 9 of the UCC or such jurisdiction, or (2) as being of an equal or lesser scope or with greater detail, and (B) may contain other information required by Part 5 of Article 9 of the UCC for the sufficiency or filing office acceptance of any financing statement or amendment, including (X) whether Grantor is an organization, the type of organization and any organization identification number issued to the Grantor, and (Y) in the case of a financing statement filed as a fixture filing or indicating Collateral as as-extracted collateral, a sufficient description of real property to which the Collateral relates. Grantor agrees to furnish any such information to Secured Party promptly upon request.

(b) **Securities Collateral.** Without limiting the generality of the foregoing Section 5(a), except to the extent that certain Collateral may be limited by the terms of the Subordination Agreement or any Future Subordination Agreement, Grantor agrees that it will, upon obtaining any Pledged Shares, promptly (and in any event within five Business Days) notify Secured Party of such and enter into a Pledge Agreement with Secured Party with respect to the pledge thereof, in form and substance reasonably acceptable to Secured Party (the "**Pledge Agreement**"); provided, that the failure of Grantor to execute a Pledge Agreement with respect to any Pledged Shares shall not impair the security interest of Secured Party therein or otherwise adversely affect the rights and remedies of Secured Party hereunder with respect thereto.

(c) **Intellectual Property Collateral.** Without limiting the generality of the foregoing Section 5(a), if Grantor shall hereafter obtain rights to any new Intellectual Property Collateral or become entitled to the benefit of (i) any patent application or patent or any reissue, division, continuation, renewal, extension or continuation-in-part of any Patent or any improvement of any Patent; or (ii) any Copyright Registration, application for Registration or renewals or extension of any Copyright, then in any such case, the provisions of this Agreement shall automatically apply thereto. Grantor shall promptly notify Secured Party in writing of any of the foregoing rights acquired by Grantor after the date hereof and of (i) any Trademark Registrations issued or application for a Trademark Registration or

application for a Patent made, and (ii) any Copyright Registrations issued or applications for Copyright Registration made, in any such case, after the date hereof. Grantor hereby authorizes Secured Party to modify this Agreement without obtaining Grantor's approval of or signature to such modification by amending **Schedules 1(f)(i), 1(f)(ii), and 1(f)(iii)** hereto, as applicable, to include reference to any right, title or interest in any existing Intellectual Property Collateral or any Intellectual Property Collateral acquired or developed by Grantor after the execution hereof or to delete any reference to any right, title or interest in any Intellectual Property Collateral in which Grantor no longer has or claims any right, title or interest.

SECTION 6. Certain Covenants of Grantor.

Grantor shall:

- (a) not use or permit any Collateral to be used unlawfully or in violation of any provision of this Agreement or any applicable statute, regulation or ordinance or any policy of insurance covering the Collateral;
- (b) notify Secured Party in writing of any change in Grantor's name, identity or corporate structure 15 days prior to such change;
- (c) give Secured Party 30 days' prior written notice of any change in Grantor's chief place of business, chief executive office, jurisdiction of organization, type of entity or residence or the office where Grantor keeps its records regarding the Accounts and all originals of all chattel paper that evidence Accounts; and
- (d) pay promptly when due all property and other taxes, assessments and governmental charges or levies imposed upon, and all claims (including claims for labor, services, materials and supplies) against, the Collateral, except to the extent the validity thereof is being contested in good faith; provided that Grantor shall in any event pay such taxes, assessments, charges, levies or claims not later than five days prior to the date of any proposed sale under any judgment, writ or warrant of attachment entered or filed against Grantor or any of the Collateral as a result of the failure to make such payment.

SECTION 7. Special Covenants With Respect to Equipment and Inventory.

Grantor shall:

- (a) keep the Equipment and Inventory (except for Inventory which, in the ordinary course of business, is in transit either (i) from a supplier to Grantor, (ii) between the locations specified in **Schedule 4(b)**, or (iii) to customers of Grantor) owned by Grantor at the places therefor specified on **Schedule 4(b)** or, upon 30 days' prior written notice to Secured Party, at such other places in jurisdictions where all action that may be necessary or desirable, or that Secured Party may request, in order to perfect and protect any security interest granted or purported to be granted hereby, or to enable Secured Party to exercise and enforce its rights and remedies hereunder, with respect to such Equipment and Inventory shall have been taken;

(b) cause the Equipment owned by Grantor to be maintained and preserved in the same condition, repair and working order as when acquired by Grantor, ordinary wear and tear excepted, and in accordance with Grantor's past practices, and shall forthwith make or cause to be made all repairs, replacements and other improvements in connection therewith that are necessary or desirable to such end. Grantor shall promptly furnish to Secured Party a statement respecting any material loss or damage to any of the Equipment owned by Grantor;

(c) keep correct and accurate records of Inventory owned by Grantor, itemizing and describing the kind, type and quantity of such Inventory, Grantor's cost therefor and (where applicable) the current list prices for such Inventory;

(d) if any Inventory is in possession or control of any of Grantor's agents or processors, upon the occurrence and continuation of an Event of Default (as defined in the Notes), instruct such agent or processor to hold all such Inventory for the account of Secured Party and subject to the instructions of Secured Party; and

(e) promptly upon the issuance and delivery to Grantor of any Negotiable Document of Title, deliver such Negotiable Document of Title to Secured Party.

SECTION 8. Insurance.

(a) Grantor shall, at its own expense, maintain insurance with respect to the Equipment and Inventory.

(b) Upon (i) the occurrence and during the continuation of any Event of Default or (ii) the actual or constructive loss (in excess of \$50,000 per occurrence) of any Equipment or Inventory, all insurance payments in respect of such Equipment or Inventory shall be paid to Secured Party and applied by Secured Party as specified in Section 16.

SECTION 9. Special Covenants With Respect to Accounts and Related Contracts.

(a) Grantor shall keep its chief place of business and chief executive office and the office where it keeps its records concerning the Accounts and Related Contracts, and all originals of all chattel paper that evidence Accounts, at the location therefor specified in Section 4 or, upon 30 days' prior written notice to Secured Party, at such other location in a jurisdiction where all action that may be necessary or desirable, or that Secured Party may request, in order to perfect and protect any security interest granted or purported to be granted hereby, or to enable Secured Party to exercise and enforce its rights and remedies hereunder, with respect to such Accounts and Related Contracts shall have been taken. Grantor will hold and preserve such records and chattel paper and will permit representatives of Secured Party at any time during normal business hours to inspect and make abstracts from such records and chattel paper, and Grantor agrees to render to Secured Party, at Grantor's cost and expense, such clerical and other assistance as may be reasonably requested with regard thereto. Promptly upon the request of Secured Party, Grantor shall deliver to Secured Party complete and correct copies of each Related Contract.

(b) Grantor shall maintain (i) complete records of each Account of Grantor, including records of all payments received, credits granted and merchandise returned, and (ii) all documentation relating thereto.

(c) Except as otherwise provided in this subsection (c), Grantor shall continue to collect, at its own expense, all amounts due or to become due to Grantor under the Accounts and Related Contracts. In connection with such collections, Grantor may take (and, at the direction of Secured Party, shall take) such action as Grantor or Secured Party may deem necessary or advisable to enforce collection of amounts due or to become due under the Accounts; *provided, however*, that Secured Party shall have the right at any time, upon the occurrence and during the continuation of an Event of Default and upon written notice to Grantor of its intention to do so, to notify the account debtors or obligors under any Accounts of the assignment of such Accounts to Secured Party and to direct such account debtors or obligors to make payment of all amounts due or to become due to Grantor thereunder directly to Secured Party, to notify each Person maintaining a lockbox or similar arrangement to which account debtors or obligors under any Accounts have been directed to make payment to remit all amounts representing collections on checks and other payment items from time to time sent to or deposited in such lockbox or other arrangement directly to Secured Party and, upon such notification and at the expense of Grantor, to enforce collection of any such Accounts and to adjust, settle or compromise the amount or payment thereof, in the same manner and to the same extent as Grantor might have done. After receipt by Grantor of the notice from Secured Party referred to in the proviso to the preceding sentence and during the continuation of any Event of Default, (i) all amounts and proceeds (including checks and other instruments) received by Grantor in respect of the Accounts and the Related Contracts shall be received in trust for the benefit of Secured Party hereunder, shall be segregated from other funds of Grantor and shall be forthwith paid over or delivered to Secured Party in the same form as so received (with any necessary endorsement) to be held as cash Collateral and applied as provided by Section 16, and (ii) Grantor shall not adjust, settle or compromise the amount or payment of any Account, or release wholly or partly any account debtor or obligor thereof, or allow any credit or discount thereon.

SECTION 10. Special Covenants With Respect to the Intellectual Property Collateral.

(a) Grantor shall:

(i) diligently keep reasonable records respecting the Intellectual Property Collateral and at all times keep at least one complete set of its records concerning such Collateral at its chief executive office or principal place of business;

(ii) hereafter use best efforts so as not to permit the inclusion in any contract to which it hereafter becomes a party of any provision that could or might in any way impair or prevent the creation of a security interest in, or the assignment of, Grantor's rights and interests in any property included within the definitions of any Intellectual Property Collateral acquired under such contracts;

(iii) take any and all reasonable steps to protect the secrecy of all trade secrets relating to the products and services sold or delivered under or in connection with the Intellectual Property Collateral, including, without limitation, where appropriate entering into confidentiality agreements with employees and labeling and restricting access to secret information and documents;

(iv) use proper statutory notice in connection with its use of any of the Intellectual Property Collateral;

(v) use a commercially appropriate standard of quality (which may be consistent with Grantor's past practices) in the manufacture, sale and delivery of products and services sold or delivered under or in connection with the Trademarks; and

(vi) furnish to Secured Party from time to time at Secured Party's reasonable request statements and schedules further identifying and describing any Intellectual Property Collateral and such other reports in connection with such Collateral, all in reasonable detail.

(b) Except as otherwise provided in this Section 10, Grantor shall continue to collect, at its own expense, all amounts due or to become due to Grantor in respect of the Intellectual Property Collateral or any portion thereof. In connection with such collections, Grantor may take (and, at Secured Party's reasonable direction, shall take) such action as Grantor or Secured Party may deem reasonably necessary or advisable to enforce collection of such amounts; *provided, however*, that Secured Party shall have the right at any time, upon the occurrence and during the continuation of an Event of Default and upon written notice to Grantor of their intention to do so, to notify the obligors with respect to any such amounts of the existence of the security interest created hereby and to direct such obligors to make payment of all such amounts directly to Secured Party, and, upon such notification and at the expense of Grantor, to enforce collection of any such amounts and to adjust, settle or compromise the amount or payment thereof, in the same manner and to the same extent as Grantor might have done. After receipt by Grantor of the notice from Secured Party referred to in the proviso to the preceding sentence and during the continuation of any Event of Default, (i) all amounts and proceeds (including checks and other instruments) received by Grantor in respect of amounts due to Grantor in respect of the Intellectual Property Collateral or any portion thereof shall be received in trust for the benefit of Secured Party hereunder, shall be segregated from other funds of Grantor and shall be forthwith paid over or delivered to Secured Party in the same form as so received (with any necessary endorsement) to be held as cash Collateral and applied as provided by Section 16, and (ii) Grantor shall not adjust, settle or compromise the amount or payment of any such amount or release wholly or partly any obligor with respect thereto or allow any credit or discount thereon.

(c) Grantor shall have the duty diligently, through counsel reasonably acceptable to Secured Party, to prosecute, file and/or make, unless and until Grantor, in its commercially reasonable judgment, decides otherwise, (i) any application relating to any of the Intellectual Property Collateral owned, held or used by Grantor and identified on Schedules 1(f)(i), 1(f)(ii) or 1(f)(iii), as applicable, that is pending as of the date of this

Agreement, (ii) any Copyright Registration on any existing or future unregistered but copyrightable works (except for works of nominal commercial value or with respect to which Grantor has determined in the exercise of its commercially reasonable judgment that it shall not seek registration), (iii) application on any future patentable but unpatented innovation or invention comprising Intellectual Property Collateral, and (iv) any Trademark opposition and cancellation proceedings, renew Trademark Registrations and Copyright Registrations and do any and all acts which are necessary or desirable to preserve and maintain all rights in all Intellectual Property Collateral in which Grantor has determined, in the exercise of its commercially reasonable judgment, there is sufficient value to warrant the expense of such preservation. Any expenses incurred in connection therewith shall be borne solely by Grantor. Subject to the foregoing, Grantor shall give Secured Party prior written notice of any abandonment of any Intellectual Property Collateral or any pending patent application or any Patent.

(d) Except as provided herein, Grantor shall have the right to commence and prosecute in its own name, as real party in interest, for its own benefit and at its own expense, such suits, proceedings or other actions for infringement, unfair competition, dilution, misappropriation or other damage, or reexamination or reissue proceedings as are necessary to protect the Intellectual Property Collateral. Secured Party shall provide, at Grantor's expense, all reasonable and necessary cooperation in connection with any such suit, proceeding or action including, without limitation, joining as a necessary party. Grantor shall promptly, following its becoming aware thereof, notify Secured Party of the institution of, or of any adverse determination in, any proceeding (whether in the United States Patent and Trademark Office, the United States Copyright Office or any federal, state, local or foreign court) or regarding Grantor's ownership, right to use, or interest in any Intellectual Property Collateral. Grantor shall provide to Secured Party any information with respect thereto reasonably requested by Secured Party.

(e) In addition to, and not by way of limitation of, the granting of a security interest in the Collateral pursuant hereto, Grantor hereby assigns, transfers and conveys to Secured Party (to the extent not prohibited by Grantor's currently existing agreements governing such license or other use) the nonexclusive right and license to use all trademarks, tradenames, copyrights, patents or technical processes (including, without limitation, the Intellectual Property Collateral) owned or used by Grantor that relate to the Collateral and any other collateral granted by Grantor as security for the Secured Obligations, together with any goodwill associated therewith, all to the extent necessary to enable Secured Party to realize on the Collateral in accordance with this Agreement and to enable any transferee or assignee of the Collateral to enjoy the benefits of the Collateral. This right shall inure to the benefit of all successors, assigns and transferees of Secured Party and its successors, assigns and transferees, whether by voluntary conveyance, operation of law, assignment, transfer, foreclosure, deed in lieu of foreclosure or otherwise. Such right and license shall be granted free of charge, without requirement that any monetary payment whatsoever be made to Grantor. In addition, Grantor hereby grants to Secured Party, and its employees, representatives and agents the right to visit Grantor's and any of its affiliate's or subcontractor's plants, facilities and other places of business that are utilized in connection with the manufacture, production, inspection, storage or sale of products and services sold or delivered under any of the Intellectual Property Collateral, and to inspect the quality control

and all other records relating thereto upon reasonable advance written notice to Grantor and at reasonable dates and times and as often as may be reasonably requested. If and to the extent that Grantor is permitted to license the Intellectual Property Collateral, Secured Party shall promptly enter into a non-disturbance agreement or other similar arrangement, at Grantor's request and expense, with Grantor and any licensee of any Intellectual Property Collateral permitted hereunder in form and substance reasonably satisfactory to Secured Party pursuant to which (i) Secured Party shall agree not to disturb or interfere with such licensee's rights under its license agreement with Grantor so long as such licensee is not in default thereunder, and (ii) such licensee shall acknowledge and agree that the Intellectual Property Collateral licensed to it is subject to the security interest created in favor of Secured Party and the other terms of this Agreement.

SECTION 11. Secured Party Appointed Attorney-in-Fact.

Grantor hereby irrevocably appoints Secured Party as Grantor's attorney-in-fact, with full authority in the place and stead of Grantor and in the name of Grantor, Secured Party or otherwise, from time to time in Secured Party's discretion to take the following actions upon the occurrence and during the continuance of an Event of Default:

(a) to obtain and adjust insurance required to be maintained by Grantor or paid to Secured Party pursuant to Section 8;

(b) to ask for, demand, collect, sue for, recover, compound, receive and give acquittance and receipts for moneys due and to become due under or in respect of any of the Collateral;

(c) to receive, endorse and collect any drafts or other instruments, documents and chattel paper in connection with clauses (a) and (b) above;

(d) to file any claims or take any action or institute any proceedings that Secured Party may deem necessary or desirable for the collection of any of the Collateral or otherwise to enforce the rights of Secured Party with respect to any of the Collateral;

(e) to pay or discharge taxes or Liens (other than Liens permitted under this Agreement) levied or placed upon or threatened against the Collateral, the legality or validity thereof and the amounts necessary to discharge the same to be determined by Secured Party in its sole discretion, any such payments made by any Secured Party to become obligations of Grantor to Secured Party, due and payable immediately without demand;

(f) to sign and endorse any invoices, freight or express bills, bills of lading, storage or warehouse receipts, drafts against debtors, assignments, verifications and notices in connection with Accounts and other documents relating to the Collateral; and

(g) upon the occurrence and during the continuance of an Event of Default and subject to the requirements that Secured Party act in a commercially reasonable manner with respect to the disposition of Collateral in accordance with the relevant UCC, generally to sell, transfer, pledge, make any agreement with respect to or otherwise deal with any of the Collateral as fully and completely as though Secured Party were the absolute owner thereof

for all purposes, and to do, at Secured Party's option and Grantor's expense, at any time or from time to time, all acts and things that Secured Party deems necessary to protect, preserve or realize upon the Collateral and Secured Party's security interest therein in order to effect the intent of this Agreement, all as fully and effectively as Grantor might do.

SECTION 12. Secured Party May Perform.

If Grantor fails to perform any agreement contained herein, Secured Party may itself perform, or cause performance of, such agreement, and the expenses of Secured Party incurred in connection therewith shall be payable by Grantor under Section 17(b).

SECTION 13. Standard of Care.

The powers conferred on Secured Party hereunder are solely to protect Secured Party's interest in the Collateral and shall not impose any duty upon it to exercise any such powers. Except for the exercise of reasonable care in the custody of any Collateral in its possession and the accounting for moneys actually received by Secured Party hereunder, Secured Party shall not have any duty as to any Collateral or as to the taking of any necessary steps to preserve rights against prior parties or any other rights pertaining to any Collateral. Secured Party shall be deemed to have exercised reasonable care in the custody and preservation of Collateral in their possession if such Collateral is accorded treatment substantially equal to that which Secured Party accords its own property.

SECTION 14. Remedies.

If any Event of Default shall have occurred and be continuing, Secured Party may exercise in respect of the Collateral, in addition to all other rights and remedies provided for herein or otherwise available to it, all the rights and remedies of a secured party on default under the UCC (whether or not the UCC applies to the affected Collateral), and also may (a) require Grantor to, and Grantor hereby agrees that it will at its expense and upon request of Secured Party forthwith, assemble all or part of the Collateral as directed by Secured Party and make it available to Secured Party at a place to be designated by Secured Party that is reasonably convenient to both parties, (b) enter onto the property where any Collateral is located and take possession thereof with or without judicial process, (c) prior to the disposition of the Collateral, store, process, repair or recondition the Collateral or otherwise prepare the Collateral for disposition in any manner to the extent Secured Party deems appropriate, (d) take possession of Grantor's premises or place custodians in exclusive control thereof, remain on such premises and use the same and any of Grantor's equipment for the purpose of completing any work in process, taking any actions described in the preceding clause (c) and collecting any Secured Obligation, (e) without notice except as specified below, sell the Collateral or any part thereof in one or more parcels at public or private sale, at Secured Party's offices or elsewhere, for cash, on credit or for future delivery, at such time or times and at such price or prices and upon such other terms as Secured Party may deem commercially reasonable, and (f) exercise dominion and control over and refuse to permit further withdrawals from any Deposit Account maintained with Secured Party constituting a part of the Collateral. To the extent permitted by applicable law, Secured Party may be the purchaser of any or all of the Collateral at any such sale and Secured Party shall

be entitled, for the purpose of bidding and making settlement or payment of the purchase price for all or any portion of the Collateral sold at any such public sale, to use and apply any of the Secured Obligations as a credit on account of the purchase price for any Collateral payable by Secured Party at such sale. Each purchaser at any sale shall hold the property sold free from any claim or right on the part of Grantor, and Grantor hereby waives (to the extent permitted by applicable law) all rights of redemption, stay and/or appraisal which it now has or may at any time in the future have under any rule of law or statute now existing or hereafter enacted. Grantor agrees that, to the extent notice of sale shall be required by law, at least ten days' notice to Grantor of the time and place of any public sale or the time after which any private sale is to be made shall constitute reasonable notification. Secured Party shall not be obligated to make any sale of Collateral regardless of notice of sale having been given. Secured Party may adjourn any public or private sale from time to time by announcement at the time and place fixed therefor, and such sale may, without further notice, be made at the time and place to which it was so adjourned. Grantor hereby waives any claims against Secured Party arising by reason of the fact that the price at which any Collateral may have been sold at such a private sale was less than the price which might have been obtained at a public sale, even if Secured Party accepts the first offer received and does not offer such Collateral to more than one offeree, subject to the requirements that Secured Party act in a commercially reasonable manner with respect to the disposition of such Collateral in accordance with the relevant UCC. If the proceeds of any sale or other disposition of the Collateral are insufficient to pay all the Secured Obligations, Grantor shall remain liable for the deficiency and the fees of any attorneys employed by Secured Party to collect such deficiency. Grantor further agrees that a breach of any of the covenants contained in this Section will cause irreparable injury to Secured Party, that Secured Party has no adequate remedy at law in respect of such breach and, as a consequence, that each and every covenant contained in this Section shall be specifically enforceable against Grantor, and Grantor hereby waives and agrees not to assert any defenses against an action for specific performance of such covenants except for a defense that no default has occurred giving rise to the Secured Obligations becoming due and payable prior to their stated maturities or permitting enforcement of this Section. Nothing in this Section shall in any way alter the rights of Secured Party hereunder.

SECTION 15. Additional Remedies for Intellectual Property

Collateral.

(a) Anything contained herein to the contrary notwithstanding, upon the occurrence and during the continuation of an Event of Default, (i) Secured Party shall have the right (but not the obligation) to bring suit, in the name of Grantor, Secured Party or otherwise, to enforce any Intellectual Property Collateral, in which event Grantor shall, at the request of Secured Party, do any and all lawful acts and execute any and all documents required by Secured Party in aid of such enforcement and Grantor shall promptly, upon demand, reimburse and indemnify Secured Party as provided in Section 17 hereof in connection with the exercise of its rights under this Section, and, to the extent that Secured Party shall elect not to bring suit to enforce any Intellectual Property Collateral as provided in this Section, Grantor agrees to use all reasonable measures, whether by action, suit, proceeding or otherwise, to prevent the infringement of any of the Intellectual Property Collateral by others and for that purpose agrees to use its commercially reasonable judgment

in maintaining any action, suit or proceeding against any Person so infringing reasonably necessary to prevent such infringement; (ii) upon written demand from Secured Party, Grantor shall execute and deliver to Secured Party an assignment or assignments of the Intellectual Property Collateral and such other documents as are necessary or appropriate to carry out the intent and purposes of this Agreement; and (iii) Grantor agrees that such an assignment and/or recording shall be applied to reduce the Secured Obligations outstanding only to the extent that Secured Party receive cash proceeds in respect of the sale of, or other realization upon, the Intellectual Property Collateral.

(b) If (i) an Event of Default shall have occurred and, by reason of cure, waiver, modification, amendment or otherwise, no longer be continuing, (ii) no other Event of Default shall have occurred and be continuing, (iii) an assignment to Secured Party of any rights, title and interests in and to the Intellectual Property Collateral shall have been previously made, and (iv) the Secured Obligations shall not have become immediately due and payable, upon the written request of Grantor, Secured Party shall promptly execute and deliver to Grantor such assignments as may be necessary to reassign to Grantor any such rights, title and interests as may have been assigned to Secured Party as aforesaid, subject to any disposition thereof that may have been made by Secured Party; *provided*, after giving effect to such reassignment, Secured Party's security interest granted pursuant hereto, as well as all other rights and remedies of Secured Party granted hereunder, shall continue to be in full force and effect; and *provided further*, the rights, title and interests so reassigned shall be free and clear of all Liens other than Liens (if any) encumbering such rights, title and interest at the time of their assignment to Secured Party.

SECTION 16. Application of Proceeds.

Except as expressly provided elsewhere in this Agreement, to the extent permitted by applicable law, all proceeds received by Secured Party in respect of any sale of, collection from, or other realization upon all or any part of the Collateral may, in the discretion of Secured Party, be held by Secured Party as Collateral for, and/or then, or at any time thereafter, applied in full or in part by Secured Party against, the Secured Obligations in the following order of priority:

FIRST: To the payment of all costs and expenses of such sale, collection or other realization, including reasonable compensation to Secured Party and its agents and counsel, and all other expenses, liabilities and advances made or incurred by Secured Party in connection therewith, and all amounts for which Secured Party is entitled to indemnification hereunder and all advances made by Secured Party hereunder for the account of Grantor, and to the payment of all costs and expenses paid or incurred by Secured Party in connection with the exercise of any right or remedy hereunder, all in accordance with **Section 18**;

SECOND: To the payment of all other Secured Obligations in such order as Secured Party shall elect; and

THIRD: To the payment to or upon the order of Grantor, or to whosoever may be lawfully entitled to receive the same or as a court of competent jurisdiction may direct, of any surplus then remaining from such proceeds.

SECTION 17. Indemnity and Expenses.

(a) Grantor agrees to indemnify and hold harmless Secured Party and each Lender from and against any and all claims, losses and liabilities in any way relating to, growing out of or resulting from this Agreement and the transactions contemplated hereby (including without limitation enforcement of this Agreement), except to the extent such claims, losses or liabilities result solely from Secured Party's or a Lenders' willful breach of their respective obligations under the Subordination Agreement or any Future Subordination Agreement or Secured Party's gross negligence or willful misconduct under this Agreement, in each case, as finally determined by a court of competent jurisdiction.

(b) Grantor agrees to pay to Secured Party upon demand the amount of any and all costs and expenses, including the reasonable fees and expenses of its counsel and of any experts and agents, that Secured Party, as applicable, may incur in connection with the administration of this Agreement. Grantor further agrees to pay to Secured Party and each Lender, upon demand the amount of any and all costs and expenses, including the reasonable fees and expenses of counsel (it being understood that to the extent possible, taking into account conflict of interest issues among the Lenders and Secured Party at such time, Secured Party and Lenders shall use one counsel) and of any experts and agents, that Secured Party or the Lenders, as applicable, may incur in connection with (i) the custody, preservation, use or operation of, or the sale of, collection from, or other realization upon, any of the Collateral, (ii) the exercise or enforcement of any of the rights of Secured Party hereunder, or (iii) the failure by Grantor to perform or observe any of the provisions hereof.

(c) The obligations of Grantor in this Section 17 shall survive the termination of this Agreement and the discharge of Grantor's other obligations under this Agreement and the Notes. The indemnities set forth in this Section 17 and elsewhere in this Agreement are in addition to, and not in lieu of, the indemnities set forth elsewhere in the Notes.

SECTION 18. Continuing Security Interest; Transfer of Loans; Replacement of Secured Party.

(a) This Agreement shall create a continuing security interest in the Collateral and shall (i) remain in full force and effect until the payment in full of the Secured Obligations, (ii) be binding upon Grantor and its successors and assigns, and (iii) inure, together with the rights and remedies of (and indemnifications in favor of) Secured Party and the Lenders hereunder, to the benefit of Secured Party for the benefit of the Lenders and their successors, transferees and assigns, including any Person to whom a Lender has granted a participation interest in any of the Note. Without limiting the generality of the foregoing clause (iii), any Lender may assign or otherwise transfer the Note or any portion of the Note held by it to any other Person, including, but not limited to, any Person to whom such Lender has granted a participation interest in any of the Note, and such other Person shall thereupon become vested with all the benefits in respect thereof granted to such Lender herein or otherwise; *provided, however*, that any such participant or assignee shall exercise its rights only through Secured Party. Upon the payment in full of all Secured Obligations, the security interest granted hereby shall terminate and all rights to the Collateral shall revert to Grantor.

Upon any such termination, Secured Party will, at Grantor's expense, execute and deliver to Grantor such documents as Grantor shall reasonably request to evidence such termination.

(b) Secured Party shall be permitted to resign hereunder upon delivering 5 days prior written notice of such resignation to the Lenders, or Secured Party may be removed by the Lenders holding 66% of the Secured Obligations, and, in each case, a successor Secured Party may be appointed hereunder by the Lenders holding 66% of the Secured Obligations. Upon the acceptance of any appointment as Secured Party hereunder by a successor Secured Party, that successor Secured Party shall thereupon succeed to and become vested with all the rights, powers, privileges and duties of the retiring or removed Secured Party under this Agreement, and the retiring or removed Secured Party under this Agreement shall promptly (i) transfer to such successor Secured Party all sums, securities and other items of Collateral held hereunder, together with all records and other documents necessary or appropriate in connection with the performance of the duties of the successor Secured Party under this Agreement, and (ii) execute and deliver to such successor Secured Party, or authorize such successor Secured Party to prepare and file, such amendments to or assignments of financing statements, and take such other actions as may be necessary or appropriate in connection with the assignment to such successor Secured Party of the security interests created hereunder, whereupon such retiring or removed Secured Party shall be discharged from its duties and obligations under this Agreement. After any retiring or removed Secured Party's resignation or removal hereunder as Secured Party, the provisions of this Agreement shall inure to its benefit as to any actions taken or omitted to be taken by it under this Agreement while it was Secured Party hereunder.

SECTION 19. Additional Grantors.

From time to time subsequent to the date hereof, if Grantor forms any Subsidiary, such Subsidiary will, upon the request of Secured Party (and in any event prior to the date Grantor transfers any Collateral to such Subsidiary) execute a Security Agreement substantially in the form of this Agreement which shall also include a guarantee of the Secured Obligations and customary suretyship waivers.

SECTION 20. Subordination.

This Agreement is subject to the terms of the Subordination Agreement and any future subordination agreement (a "**Future Subordination Agreement**") between the Lenders and any Senior Lender entered into pursuant to any Senior Credit Facility in accordance with the terms of the Securities Purchase Agreement. Notwithstanding anything contained in this Agreement to the contrary, and solely to the extent required by the Securities Purchase Agreement or the Subordination Agreement or a Future Subordination Agreement, as applicable, the security interests and liens granted under this Agreement shall be subordinate to all security interests and liens granted by Grantor to any Senior Lender pursuant to any Senior Credit Facility that is entered into in accordance with the Securities Purchase Agreement, and the Grantor's obligations hereunder shall be subject to the Subordination Agreement or any Future Subordination Agreement, as may be applicable.

SECTION 21. Amendments; Etc.

Any amendment, modification, termination, waiver or consent of any provision of this Agreement shall be effective (i) with respect to Secured Party and the Lenders, only with the prior written consent of the holders of two-third (2/3) of the outstanding aggregate principal amounts of the Notes (and any such amendment, modification, termination, waiver or consent obtained pursuant to the preceding clause shall be binding on Secured Party and all Lenders) and (ii) with respect to Grantor, only with the prior written consent of Grantor. The Grantor shall be entitled to rely on the signature of Secured Party on any such modification, termination, waiver or consent as to receipt by Secured Party of the prior written consent of two-thirds (2/3) of the outstanding aggregate principal amounts of the Notes. Any such waiver or consent shall be effective only in the specific instance and for the specific purpose for which it was given.

SECTION 22. Notices.

Any notice or other communication herein required or permitted to be given shall be in writing and may be personally served, telexed or sent by telefacsimile or United States mail or courier service and shall be deemed to have been given when delivered in person or by courier service, upon receipt of telefacsimile, or three Business Days after depositing it in the United States mail with postage prepaid and properly addressed; *provided* that notices to Secured Party shall not be effective until received. For the purposes hereof, the address of each party hereto shall be as set forth under such party's name on the signature pages hereof or such other address as shall be designated by such party in a written notice delivered to the other parties hereto.

SECTION 23. Failure or Indulgence Not Waiver; Remedies Cumulative.

No failure or delay on the part of Secured Party in the exercise of any power, right or privilege hereunder shall impair such power, right or privilege or be construed to be a waiver of any default or acquiescence therein, nor shall any single or partial exercise of any such power, right or privilege preclude any other or further exercise thereof or of any other power, right or privilege. All rights and remedies existing under this Agreement are cumulative to, and not exclusive of, any rights or remedies otherwise available.

SECTION 24. Severability.

In case any provision in or obligation under this Agreement shall be invalid, illegal or unenforceable in any jurisdiction, the validity, legality and enforceability of the remaining provisions or obligations, or of such provision or obligation in any other jurisdiction, shall not in any way be affected or impaired thereby.

SECTION 25. Headings.

Section and subsection headings in this Agreement are included herein for convenience of reference only and shall not constitute a part of this Agreement for any other purpose or be given any substantive effect.

SECTION 26. Governing Law; Terms; Rules of Construction.

THIS AGREEMENT AND THE RIGHTS AND OBLIGATIONS OF THE PARTIES HEREUNDER SHALL BE GOVERNED BY, AND SHALL BE CONSTRUED AND ENFORCED IN ACCORDANCE WITH, THE INTERNAL LAWS OF THE STATE OF WASHINGTON, WITHOUT REGARD TO CONFLICTS OF LAWS PRINCIPLES, EXCEPT TO THE EXTENT THAT THE UCC PROVIDES THAT THE PERFECTION OF THE SECURITY INTEREST HEREUNDER, OR REMEDIES HEREUNDER, IN RESPECT OF ANY PARTICULAR COLLATERAL ARE GOVERNED BY THE LAWS OF A JURISDICTION OTHER THAN THE STATE OF WASHINGTON, IN WHICH CASE, THE LAW OF SUCH OTHER JURISDICTION SHALL APPLY. Unless otherwise defined herein, terms used in Chapters 8 and 9A of the Uniform Commercial Code in the State of Washington are used herein as therein defined.

SECTION 27. Consent to Jurisdiction and Service of Process.

ALL JUDICIAL PROCEEDINGS BROUGHT AGAINST GRANTOR ARISING OUT OF OR RELATING TO THIS AGREEMENT, OR ANY OBLIGATIONS HEREUNDER, MAY BE BROUGHT IN ANY STATE OR FEDERAL COURT OF COMPETENT JURISDICTION IN THE STATE OF CALIFORNIA EXCEPT TO THE EXTENT THAT THE UCC PROVIDES THAT THE ENFORCEMENT OF THE SECURITY INTERESTS OR OTHER REMEDIES HEREUNDER ARE ENFORCEABLE UNDER THE LAWS OF A JURISDICTION OTHER THAN THE STATE OF CALIFORNIA, IN WHICH CASE, SUCH ACTION MAY BE BROUGHT IN THE COURTS OF SUCH OTHER JURISDICTION. BY EXECUTING AND DELIVERING THIS AGREEMENT, GRANTOR, FOR ITSELF AND IN CONNECTION WITH ITS COLLATERAL, IRREVOCABLY (I) ACCEPTS GENERALLY AND UNCONDITIONALLY THE NONEXCLUSIVE JURISDICTION AND VENUE OF SUCH COURTS; (II) WAIVES ANY DEFENSE OF *FORUM NON CONVENIENS*; AND (III) AGREES THAT EACH SECURED PARTY RETAINS THE RIGHT TO SERVE PROCESS IN ANY MANNER PERMITTED BY LAW OR TO BRING PROCEEDINGS AGAINST GRANTOR IN THE COURTS OF ANY JURISDICTION.

SECTION 28. Waiver of Jury Trial.

GRANTOR AND EACH SECURED PARTY HEREBY AGREE TO WAIVE THEIR RESPECTIVE RIGHTS TO A JURY TRIAL OF ANY CLAIM OR CAUSE OF ACTION BASED UPON OR ARISING OUT OF THIS AGREEMENT. The scope of this waiver is intended to be all-encompassing of any and all disputes that may be filed in any court and that relate to the subject matter of this transaction, including without limitation contract claims, tort claims, breach of duty claims, and all other common law and statutory claims. Grantor and Secured Party acknowledge that this waiver is a material inducement for Grantor and Secured Party to enter into a business relationship, that Grantor and Secured Party have already relied on this waiver in entering into this Agreement and that each will continue to rely on this waiver in their related future dealings. Grantor and Secured Party further warrant and represent that each has reviewed this waiver with its legal counsel, and that each knowingly and voluntarily waives its jury trial rights following consultation with

legal counsel. THIS WAIVER IS IRREVOCABLE, MEANING THAT IT MAY NOT BE MODIFIED EITHER ORALLY OR IN WRITING (OTHER THAN BY A MUTUAL WRITTEN WAIVER SPECIFICALLY REFERRING TO THIS SECTION 28 AND EXECUTED BY EACH OF THE PARTIES HERETO), AND THIS WAIVER SHALL APPLY TO ANY SUBSEQUENT AMENDMENTS, RENEWALS, SUPPLEMENTS OR MODIFICATIONS TO THIS AGREEMENT. In the event of litigation, this Agreement may be filed as a written consent to a trial by the court.

SECTION 29. Counterparts.

This Agreement may be executed in one or more counterparts and by different parties hereto in separate counterparts, each of which when so executed and delivered shall be deemed an original, but all such counterparts together shall constitute but one and the same instrument; signature pages may be detached from multiple separate counterparts and attached to a single counterpart so that all signature pages are physically attached to the same document.

ORAL AGREEMENTS OR ORAL COMMITMENTS TO LOAN MONEY, EXTEND CREDIT, OR TO FORBEAR FROM ENFORCING REPAYMENT OF A DEBT ARE NOT ENFORCEABLE UNDER WASHINGTON LAW.

[Remainder of page intentionally left blank]

IN WITNESS WHEREOF, Grantor and Secured Party have caused this Agreement to be duly executed and delivered by their respective officers thereunto duly authorized as of the date first written above.

GRANTOR:

ADVANCED H2O, INC.

By:  _____

Its: _____

SECURED PARTY:

ST. CLOUD CAPITAL PARTNERS, L.P.,

By: SCCP, LLC
Its: General Partner

By: _____
Cary S. Fitchey, Senior Managing
Member

IN WITNESS WHEREOF, Grantor and Secured Party have caused this Agreement to be duly executed and delivered by their respective officers thereunto duly authorized as of the date first written above.

GRANTOR:

ADVANCED H2O, INC.


By: _____

Its: _____

SECURED PARTY:

ST. CLOUD CAPITAL PARTNERS, L.P.,

By: SCCP, LLC
Its: General Partner

By: 
Cary S. Fitchey, Senior Managing
Member

**St. Cloud Capital, Seacoast Capital and Advanced H2O
Security Agreement
Schedule 1(f)(i)**

U.S. Trademarks:

<u>Registered Owner</u>	<u>Trademark Description</u>	<u>Registration Number</u>	<u>Registration Date</u>
Advanced H2O	ZAQUA	2,505,528	11-6-2001
Advanced H2O	Microstructured	2,640,164	10-22-2002

U.S. Trademarks Pending:

<u>Registered Owner</u>	<u>Trademark Description</u>	<u>Registration Number</u>	<u>Registration Date</u>
Advanced H2O	Simply Smooth, Purely Delicious	76/394,045	NOA Date 2-4-03

Foreign Trademarks:

<u>Registered Owner</u>	<u>Trademark Description</u>	<u>Registration Number</u>	<u>Registration Date</u>
Advanced H2O	Cascade Clear	TMA 510,892 836988	11-1-2002

**St. Cloud Capital, Seacoast Capital and Advanced H2O
Security Agreement
Schedule 1(f)(ii)**

U.S. Patents Issued:

<u>Patent No.</u>	<u>Issue Date</u>	<u>Invention</u>	<u>Inventor</u>
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None

U.S. Patents Pending:

<u>Applicant's Name</u>	<u>Date Filed</u>	<u>Application Number</u>	<u>Invention</u>	<u>Inventor</u>
Robert Abramowitz	4-25-2001	09/843/086	Process for Producing Alkaline drinking water	Abramowitz

Foreign Patents Issued:

None

Foreign Patents Pending:

None

**St. Cloud Capital, Seacoast Capital and Advanced H2O
Security Agreement
Schedule 1(f)(iii)**

U.S. Copyrights:

<u>Title</u>	<u>Registration No.</u>	<u>Date of Issue</u>	<u>Registered Owner</u>
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None

Foreign Copyrights Registration:

<u>County</u>	<u>Title</u>	<u>Registration No.</u>	<u>Date of issue</u>
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None

Pending U.S. Copyright Registration & Applications

<u>Title</u>	<u>Reference No.</u>	<u>Date of Application</u>	<u>Copyright Claimant</u>
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None

Pending Foreign Copyright Registration & Applications:

<u>County</u>	<u>Title</u>	<u>Registration No.</u>	<u>Date of Issue</u>
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None

**St. Cloud Capital, Seacoast Capital and Advanced H2O
Security Agreement
Schedule 1(h)**

Commercial tort claims.

None.

**St. Cloud Capital, Seacoast Capital and Advanced H2O
Security Agreement
Schedule 4(b)**

Location of Equipment and Inventory

<u>Name of Grantor</u>	<u>Location of Equipment and Inventory</u>
Advanced H2O	Burlington Plant 1600 Port Drive Burlington, WA 98233
	Kent Warehouse 7816 S. 184th ST. Kent, WA. 98032
	Holman 2300 SE Beta Milwaukie, OR 97222
	Northstar Beverage Co 8462 S. 190th Street Kent, WA 98031

**St. Cloud Capital, Seacoast Capital and Advanced H2O
Security Agreement
Schedule 4(c)**

Negotiable Instruments of Title with respect to Inventory.

None.

**St. Cloud Capital, Seacoast Capital and Advanced H2O
Security Agreement
Schedule 4(d)**

Office locations

<u>Name of Grantor</u>	<u>Office Locations</u>
Advanced H2O	13226 SE 30th Suite B-3 Bellevue, WA 98005

**St. Cloud Capital, Seacoast Capital and Advanced H2O
Security Agreement
Schedule 4(e)(i)**

Other Names

None

**St. Cloud Capital, Seacoast Capital and Advanced H2O
Security Agreement
Schedule 4(e)(ii)**

Grantor Information

Grantor's Name: **Advanced H2O, Inc.**

Type of entity: **Corporation**

UBI Number: **601 878 589**