

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2009

OR

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

for the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 0-14710

**XOMA Ltd.**

(Exact name of registrant as specified in its charter)

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

**2910 Seventh Street, Berkeley,  
California 94710**  
(Address of principal executive offices,  
including zip code)

**52-2154066**  
(I.R.S. Employer  
Identification No.)

**(510) 204-7200**  
(Telephone Number)

**Securities registered pursuant to Section 12(b) of the Act:**

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Shares, U.S. \$0.0005 par value	The NASDAQ Global Market
Preference Share Purchase Rights	

**Securities registered pursuant to Section 12(g) of the Act:**

None

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large Accelerated Filer  Accelerated Filer  Non-Accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act of 1934). Yes  No

The aggregate market value of voting shares held by non-affiliates of the registrant is \$134,644,609 as of June 30, 2009

Number of Common Shares outstanding as of March 9, 2010: 261,191,984

**DOCUMENTS INCORPORATED BY REFERENCE:**

Portions of the Company's Proxy Statement for the Company's 2010 Annual General Meeting of Shareholders are incorporated by reference into Part III of this Report.

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**XOMA Ltd.**  
**2009 FORM 10-K ANNUAL REPORT**  
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**PART I**

**Item 1. Business**

**Overview**

XOMA Ltd. (“XOMA”), a Bermuda company, is a biopharmaceutical company focused on the discovery, development and manufacture of therapeutic antibodies designed to treat inflammatory, autoimmune, infectious and oncological diseases. Our proprietary development pipeline includes XOMA 052, an anti-interleukin-1 beta (“IL-1 beta”) antibody, XOMA 3AB, a biodefense anti-botulism antibody candidate, and preclinical antibody discovery programs in several indications. We have a fully integrated product development platform, extending from preclinical science to development and manufacturing. We have multiple revenue streams resulting from the licensing of antibody technologies, biodefense contracts and discovery and development collaborations and product royalties. Our technologies have contributed to the success of marketed antibody products, including LUCENTIS® (ranibizumab injection) for wet age-related macular degeneration and CIMZIA® (certolizumab pegol) for rheumatoid arthritis and Crohn’s disease.

We have established on-going technology licensing programs for certain of our proprietary technologies, which have attracted numerous significant licensees including Bayer Healthcare AG, Johnson & Johnson (formerly Centocor, Inc.), Merck & Co., Inc. (“Merck”), Pfizer Inc. (“Pfizer”) and Takeda Pharmaceutical Company Limited (“Takeda”). We have a premier antibody discovery and development platform that includes multiple antibody discovery or phage display libraries that increase our ability and that of our partners to discover new therapeutic antibodies. Once an antibody is discovered, we use a number of proprietary technologies including our Human Engineering™, affinity maturation, bacterial cell expression and manufacturing technologies to enhance and improve the qualities of the antibodies for efficacy, safety, stability, productivity and cost. Some of XOMA’s technologies are used widely across the industry and have generated significant revenues for the company. For example, bacterial cell expression technology is a key biotechnology for the discovery and manufacture of antibodies and other proteins. Thus far, more than 50 pharmaceutical and biotechnology companies have signed bacterial cell expression licenses with us, and a number of licensed product candidates are in clinical development.

Our biodefense initiatives currently include a \$65 million multiple-year contract funded by the National Institute of Allergy and Infectious Diseases (“NIAID”), a part of the National Institutes of Health (“NIH”), to support our ongoing development of drug candidates toward clinical trials in the treatment of botulism poisoning. XOMA also develops products with premier pharmaceutical companies including Novartis AG (“Novartis”), Schering-Plough Research Institute, a division of Schering Corporation, now a subsidiary of Merck (referred to herein as “Merck/Schering-Plough”) and Takeda.

**Strategy**

We are advancing a pipeline of biologic products using our proven expertise, technologies and capabilities from antibody discovery through product development. We seek to expand our pipeline by developing proprietary products and technologies, providing contract services to government agencies responsible for biodefense and entering into licensing and collaborative arrangements with pharmaceutical and biotechnology companies. The principal elements of our strategy are to:

- **Focus on advancing XOMA 052, our lead product candidate.** Using our proprietary antibody technologies, capabilities and expertise, we discovered XOMA 052, an anti-IL-1 beta antibody, currently in Phase 2 clinical development for Type 2 diabetes, Type 1 diabetes, cardiovascular disease and other diseases. XOMA 052 has the potential to address the underlying inflammatory causes of a wide range of unmet medical needs by targeting IL-1 beta, which triggers inflammatory pathways in the body. In 2009, we successfully completed Phase 1 clinical development of XOMA 052 in Type 2 diabetes patients in which XOMA 052 was well-tolerated in a wide range of doses and demonstrated biological activity in diabetic outcomes and biomarkers of cardiovascular risk and inflammation.

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- **Generate licensing revenue from proprietary technologies and collaborations.** We have a history of generating significant revenue from our proprietary technologies, including our antibody phage display libraries and our bacterial cell expression technology. In 2009, we entered into technology collaborations with several companies to provide access to multiple proprietary antibody research and development technologies. In addition, we have licensed our bacterial cell expression technology to more than 50 companies in exchange for license, milestone and other fees, royalties and complementary technologies, and a number of licensed product candidates are in clinical development. We believe that we can continue to generate significant revenue from our proprietary technologies in the future.
- **Continue building biodefense business.** To date, we have been awarded three contracts, totaling nearly \$100 million, from NIAID, to support our ongoing development of XOMA 3AB and additional product candidates toward clinical trials in the treatment of botulism poisoning. In addition, in 2009 we expanded our biodefense programs to include two subcontracts with SRI International totaling \$3.9 million, funded through NIAID, for the development of antibodies to neutralize H1N1 and H5N1 influenza viruses and the virus that causes severe acute respiratory syndrome (“SARS”). We will continue to seek further opportunities to work with government and other institutions.

### **Proprietary Products**

As part of our strategy, we are focusing our technology and resources on advancing our emerging proprietary pipeline. Below is a summary of our proprietary products:

- **XOMA 052** is a potent monoclonal antibody with the potential to improve the treatment of patients with a wide variety of inflammatory diseases. XOMA 052 binds strongly to IL-1 beta, a pro-inflammatory cytokine involved in the development of Type 2 diabetes, cardiovascular disease, rheumatoid arthritis, gout and other diseases. By binding to IL-1 beta, XOMA 052 inhibits the activation of the IL-1 receptor, thereby preventing the cellular signaling events that produce inflammation. XOMA 052 is a humanized IgG2 antibody with a half-life of 22 days. Based on its binding properties, specificity to IL-1 beta and half-life, XOMA 052 may provide convenient dosing of once per month or less frequently.

In the fourth quarter of 2009, we announced the initiation of our Phase 2 clinical program for XOMA 052 in Type 2 diabetes, Type 1 diabetes and cardiovascular disease. The clinical trials are designed to further evaluate the use of multiple dose regimens on the safety, pharmacodynamics and efficacy of XOMA 052 in cardiometabolic and other diseases, and based on positive results, select doses for pivotal Phase 3 studies. In February of 2010, we announced that enrollment had begun in a 325-patient Phase 2 dose-ranging clinical trial of XOMA 052 in Type 2 diabetes patients. The initiation of the Phase 2 clinical program follows the announcement in July of 2009 of positive results from the U.S. Phase 1 trial, which continued to demonstrate that XOMA 052 is well tolerated in patients. Further XOMA 052 showed clinically meaningful reductions in glycosylated hemoglobin, fasting blood glucose, high sensitivity C-reactive protein and erythrocyte sedimentation rate, a standard biomarker of systemic inflammation and cardiovascular risk. Generally, a more consistent response was seen across patients in a multiple dose regimen compared to the single dose regimens. Pharmacokinetic results continue to support monthly or less frequent dosing.

We developed XOMA 052 using our proprietary antibody technologies, capabilities and expertise. XOMA owns worldwide rights to the antibody and related intellectual property.

- **XOMA 3AB** is a multi-antibody product designed to neutralize the most potent of the botulinum toxins, Type A, which causes paralysis and is a bioterrorism threat. Our anti-botulism program was recently expanded to include additional product candidates and is the first of its kind to combine multiple human antibodies to target a broad spectrum of the most toxic botulinum toxins, including the three most toxic serotypes of botulism, Types A, B and E. The antibodies are designed to bind to each

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toxin and enhance the clearance of the toxin from the body. The use of multiple antibodies increases the likelihood of clearing the harmful toxins by providing specific protection against each toxin type. In contrast to existing agents that treat botulism, XOMA uses advanced human monoclonal antibody technologies in an effort to achieve superior safety, potency and efficacy, and avoid life threatening immune reactions associated with animal-derived products.

XOMA 3AB is in the pre-Investigational New Drug (“IND”) stage, currently in nonclinical studies to assess safety through funding provided by NIAID. We have a history of successfully providing contract services to the U.S. government for the development of anti-botulinum neurotoxin antibodies.

- **Preclinical Product Pipeline:** We are pursuing additional opportunities to further broaden our preclinical product pipeline. These include internal discovery programs, product development collaborations with other pharmaceutical and biotechnology companies and evaluations of product in-licensing, in-kind product trades and acquisition opportunities.

### **Partnership Products**

XOMA partners with world-class organizations in research and development of new antibody products. Below is a list of activities in 2009 through such collaborations:

- **Therapeutic Antibodies with Takeda:** Since 2006, Takeda has been a partner for therapeutic monoclonal antibody discovery and development against multiple targets selected by them. In February of 2009, we expanded our existing collaboration to provide Takeda with access to multiple antibody technologies, including a suite of research and development technologies and integrated information and data management systems. As part of the expanded collaboration, we received a \$29 million expansion fee, before taxes and other costs, and we may receive potential milestones and royalties on sales of antibody products in the future.
- **Therapeutic Antibodies with Merck/Schering-Plough:** Merck/Schering-Plough has been a partner since 2006 for therapeutic monoclonal antibody discovery and development against multiple targets selected by them, and we are currently supporting development through this partnership.
- **Therapeutic Antibodies with Novartis:** In November of 2008, we restructured our product development collaboration with Novartis. Under the restructured agreement, Novartis received control over the two ongoing programs under the original product development collaboration entered into in 2004 with Novartis (then Chiron Corporation). In exchange, we recognized \$13.7 million in revenue in 2008 and may, in the future, receive milestones and double-digit royalty rates for the programs and options to develop or receive royalties on four additional programs. In December of 2008, we entered into a Manufacturing and Technology Transfer Agreement with Novartis, effective July 1, 2008. Under this agreement, XOMA was engaged by Novartis to perform research and development, process development, manufacturing and technology transfer activities with respect to the ongoing product programs now controlled by Novartis under the restructured product development collaboration. We completed this work in the third quarter of 2009.

### **Royalties and Technology Licenses**

#### *Royalties*

XOMA earns low-single digit royalties on sales of CIMZIA® (certolizumab pegol) in the U.S. and Canada from UCB Celltech, a branch of UCB S.A. (“UCB”). Royalties earned from these sales were \$0.5 million in 2009 and \$0.1 in 2008. CIMZIA®, an anti-tumor necrosis factor product, was approved by the U.S. Food and Drug Administration (“FDA”) in April of 2008 for the treatment of moderate-to-severe Crohn’s disease in adults who have not responded to conventional therapies. In addition, CIMZIA® was approved for the treatment of moderate-to-severe rheumatoid arthritis in adults by the FDA in May of 2009 and in Canada in September of 2009. UCB is responsible for the marketing and sales effort in support of this product. According to UCB, worldwide net sales of CIMZIA® were approximately \$104.6 million during 2009.

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XOMA earned mid- and low-single digit royalties on the following marketed antibody products in 2009:

- **LUCENTIS® (ranibizumab injection) by Genentech, Inc., a wholly-owned member of the Roche Group (referred to herein as “Genentech”):** LUCENTIS®, for the treatment of neovascular wet age-related macular degeneration, was approved by the FDA in June of 2006 and in the European Union in January of 2007, where it is distributed by Novartis. It is the first marketed therapeutic product manufactured under a license using our bacterial cell expression technology. In the third quarter of 2009, we sold our LUCENTIS® royalty interest to Genentech for \$25 million, which included the receipt of royalties of \$2.7 million earned in the second quarter of 2009 and an additional cash payment of \$22.3 million. We earned royalties on worldwide sales of LUCENTIS® for the first half of 2009 of \$5.1 million. During 2008, we earned royalties on worldwide sales of LUCENTIS® of \$8.8 million.
- **RAPTIVA® (efalizumab) with Genentech:** RAPTIVA®, a humanized therapeutic monoclonal antibody, was the first biologic therapy designed to provide long-term control of chronic moderate-to-severe plaque psoriasis. RAPTIVA® was approved by the FDA in October of 2003 and in the European Union in September of 2004. RAPTIVA® was withdrawn from the commercial drug markets due to safety concerns in the first half of 2009, at which point royalties from RAPTIVA® sales ceased. In 2009, we earned royalties of \$1.2 million from worldwide sales of RAPTIVA®, compared with \$12.2 million during 2008. Refer to “*We do not know whether there will be, or will continue to be, a viable market for the products in which we have an ownership or royalty interest*” and “*We are exposed to an increased risk of product liability claims, and a series of related cases is currently pending against us*” under *Item 1A: Risk Factors* for a discussion of certain risks associated with RAPTIVA®.

### **Technology Licenses**

Below is a summary of certain proprietary technologies owned by us and available for licensing to other companies:

- **Antibody discovery technologies:** XOMA uses human antibody phage display libraries in its discovery of therapeutic candidates, and we offer access to multiple libraries, including novel libraries developed internally, as part of our collaboration business. We believe that access to multiple libraries offers a number of benefits to XOMA and its partners, because it enables use of libraries best suited to the needs of a particular discovery project to increase the probability of technical and business success in finding rare and unique functional antibodies directed to targets of interest.  
  
In 2009, we recognized \$42.3 million in revenue related to the licensing of our antibody discovery technologies. In February of 2009, we expanded our existing collaboration with Takeda to provide Takeda with access to multiple antibody discovery technologies for a \$29 million expansion fee, before taxes and other costs. In addition, in the second half of 2009, we entered into antibody discovery collaborations with Arana Therapeutics Limited, a wholly-owned subsidiary of Cephalon, Inc. (“Arana”), and The Chemo-Sero-Therapeutic Research Institute, a Japanese research foundation known as Kaketsuken, involving multiple proprietary XOMA antibody research and development technologies for fees of \$6 million and \$8 million, respectively. We may be entitled to future milestone payments and royalties on product sales related to the antibody discovery collaborations.
- **Bacterial Cell Expression:** The production or expression of antibodies using bacteria is an enabling technology for the discovery and selection, as well as the development and manufacture, of recombinant protein pharmaceuticals, including diagnostic and therapeutic antibodies for commercial purposes. Genetically engineered bacteria are used in the recombinant expression of target proteins for biopharmaceutical research and development. Reasons include the relative simplicity of gene expression in bacteria as well as many years of experience culturing such species as *E. coli* in laboratories and manufacturing facilities. In support of our own biopharmaceutical development efforts, XOMA scientists have developed bacterial expression technologies for producing antibodies and other recombinant protein products.

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We have granted over 50 licenses to biotechnology and pharmaceutical companies to use our patented and proprietary technologies relating to bacterial expression of recombinant pharmaceutical products. Bacterial antibody expression is also a key technology used in multiple systems for high-throughput screening of antibody domains. Expression of antibodies by phage display technology, for example, depends upon the expression and secretion of antibody domains from bacteria as properly folded, functional proteins.

Many licensees of our bacterial cell expression technology have developed, or are in the process of developing, antibodies for which we may be entitled to future milestone payments and royalties on product sales. Under the terms of our license agreement with Pfizer, signed in 2007, we received an up-front cash payment of \$30 million and from 2008 through 2009 we received four milestone payments relating to four undisclosed product candidates, including a payment of \$0.5 million for the initiation of a Phase 3 clinical trial. We are also eligible for additional milestone, royalty and other fees on future sales of all products subject to this license.

Current licensees include but are not limited to the following companies:

Active Biotech AB	Crucell Holland B.V.	Novartis AG
Affimed Therapeutics AG	Dompe, s.p.a.	Pfizer, Inc.
Affitech AS	Dyax Corp.	Schering Corporation (now a subsidiary of Merck & Co., Inc.)
Alexion Pharmaceuticals, Inc.	E.I. duPont de Nemours and Company	Takeda Pharmaceutical Company Ltd.
Applied Molecular Evolution, Inc. (now a subsidiary of Eli Lilly and Company)	Eli Lilly and Company	The Medical Research Council
Avecia Limited	Genentech, Inc. (now a member of the Roche Group)	UCB S.A.
Aventis Pharma Deutschland GmbH (Hoechst) (now Sanofi-Aventis)	Invitrogen Corporation	Unilever plc
Bayer Healthcare AG	Merck & Co., Inc.	Verenium Corporation
BioInvent International AB	Mitsubishi Tanabe Pharma Corporation	Wyeth Pharmaceuticals Division (now a member of Pfizer, Inc.)
Centocor, Inc.	MorphoSys AG	ZymoGenetics, Inc.

These licenses are sometimes associated with broader agreements which may include expanded license rights, cell line development and process development.

- **Human Engineering™:** Human Engineering™ is a proprietary technology that allows modification of non-human monoclonal antibodies to reduce or eliminate detectable immunogenicity and make them suitable for medical purposes in humans. The technology uses a unique method developed by us, based on analysis of the conserved structure-function relationships among antibodies. The method defines which residues in a non-human variable region are candidates to be modified. The result is a Human Engineered™ antibody with preserved antigen binding, structure and function, and with eliminated or greatly reduced immunogenicity. Human Engineering™ technology is used in development of XOMA 052 and certain other antibody products.
- **Targeted Affinity Enhancement™ (TAE):** TAE is a proprietary technology involving the assessment and guided substitution of amino acids in antibody variable regions, enabling efficient optimization of

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antibody binding affinity and selectivity modulation. TAE generates a comprehensive map of the effects of amino acid mutations likely to impact binding. The technology is utilized by XOMA scientists and has been licensed to a number of our collaborators.

We also have access to certain intellectual property rights and services that augment our existing integrated antibody technology platform and development capabilities and further compress product development timelines. This broad antibody technology platform and expertise is available for building our antibody product pipeline as well as those of our collaborators.

### **Proprietary Product Summary:**

The following table describes important information related to the proprietary products we are currently developing:

<u>Program</u>	<u>Description</u>	<u>Indication</u>	<u>Status</u>	<u>Developer</u>
<b>XOMA 052</b>	HE™ antibody to IL-1 beta	Type 2 diabetes, Type 1 diabetes, cardiovascular disease and rheumatology disease	Phase 2 for Type 2 diabetes, Type 1 diabetes, cardiovascular disease	Proprietary
<b>XOMA 3AB</b>	Therapeutic antibodies to multiple botulinum neurotoxins	Botulism poisoning	Pre-IND	Proprietary (NIAID-funded)
<b>Multiple preclinical programs</b>	Fully human monoclonal antibodies to undisclosed disease targets	Inflammatory, autoimmune, infectious and oncological diseases	Preclinical	Proprietary

### **Partnership Product Summary:**

The following table describes important information related to certain products that we are currently developing or have developed in the past, for which we may earn royalties on product sales in the future:

<u>Program</u>	<u>Description</u>	<u>Indication</u>	<u>Status</u>	<u>Developer</u>
<b>Therapeutic antibodies</b>	Fully human monoclonal antibodies to undisclosed disease targets	Undisclosed	Preclinical	Takeda (fully-funded)
<b>Therapeutic antibodies</b>	Fully human monoclonal antibodies to undisclosed disease targets	Undisclosed	Pre-IND	Merck/Schering-Plough (fully-funded)
<b>HCD 122 and other therapeutic antibodies</b>	Fully human antibody to CD40 and other monoclonal antibodies to undisclosed disease targets	B-cell cancers and other undisclosed diseases	Various phases of clinical and preclinical development	Novartis

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### **Licensed Product Summary:**

The following table describes important information related to certain products developed under licenses with us, for which we earn or may earn royalties on product sales in the future:

<u>Program</u>	<u>Description</u>	<u>Indication</u>	<u>Status</u>	<u>Developer</u>
<b>CIMZIA® (certolizumab pegol)</b>	Anti-TNF alpha antibody fragment	Rheumatoid arthritis and Crohn's disease	Marketed in the U.S. and Canada for which XOMA earns royalties on product sales	UCB (marketed product)
<b>Various products in development by Pfizer</b>	Various monoclonal antibodies to undisclosed disease targets	Undisclosed diseases	Various phases of clinical and preclinical development	Pfizer
<b>Various products in development by other licensees</b>	Various monoclonal antibodies to undisclosed disease targets	Undisclosed diseases	Various phases of clinical and preclinical development	Various licensees

### **Financial and Legal Arrangements of Product Collaborations, Licensing and Other Arrangements**

#### ***Current Agreements***

##### ***Takeda***

In November of 2006, we entered into a fully funded collaboration agreement with Takeda for therapeutic monoclonal antibody discovery and development. Under the agreement, we will discover and optimize therapeutic antibodies against multiple targets selected by Takeda. Takeda will make up-front, annual maintenance and milestone payments to us, fund our research and development and manufacturing activities for preclinical and early clinical studies and pay royalties on sales of products resulting from the collaboration. Takeda will be responsible for clinical trials and commercialization of drugs after an IND submission and is granted the right to manufacture once a product enters into Phase 2 clinical trials. In the fourth quarter of 2009, certain discovery and development programs under this collaboration were discontinued following analysis of the research data. This resulted in the recognition of \$2.8 million of the remaining unamortized balance in deferred revenue pertaining to the discontinued programs.

In February of 2009 we expanded our existing collaboration to provide Takeda with access to multiple antibody technologies, including a suite of research and development technologies and integrated information and data management systems. We received a \$29 million expansion fee, of which \$23.2 million was received in cash in February of 2009 and the remainder was withheld for payment to the Japanese taxing authority. After deducting \$0.9 million in costs incurred through the third quarter of 2009 related to the agreement, we recognized \$28.1 million in revenue in 2009. We may receive potential milestones and royalties on sales of antibody products in the future.

##### ***Arana***

In September of 2009, we entered into an antibody discovery collaboration with Arana, a wholly-owned subsidiary of Cephalon, Inc., involving multiple proprietary XOMA antibody research and development technologies, including a new antibody phage display library and a suite of integrated information and data

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management systems. Arana agreed to pay us a fee of \$6 million, and we may be entitled to future milestone payments, aggregating up to \$3 million per product, and royalties on product sales.

### ***Kaketsuken***

In October of 2009, we entered into an antibody discovery collaboration with Kaketsuken, a Japanese research foundation, involving multiple proprietary XOMA antibody research and development technologies, including a new antibody phage display library and a suite of integrated information and data management systems. Kaketsuken agreed to pay us a fee of \$8 million, and we may be entitled to future milestone payments, aggregating up to \$0.2 million per product, and royalties on product sales.

### ***NIAID***

In March of 2005, we were awarded a \$15 million competitive bid contract from NIAID to develop three anti-botulinum neurotoxin monoclonal antibodies. Under this contract, we created production cell lines using our proprietary antibody expression systems, built Master and Manufacturer's Working Cell Banks, developed production processes and produced initial quantities of the three antibodies. The contract was performed over an 18-month period and was fully funded with federal funds from NIAID under Contract No. HHSN266200500004C. Final acceptance of the project was received in October of 2006.

In July of 2006, we were awarded a \$16.3 million contract funded with federal funds from NIAID under Contract No. HHSN266200600008C/N01-AI-60008 to produce monoclonal antibodies for the treatment of botulism to protect United States citizens against the harmful effects of botulinum neurotoxins used in bioterrorism. Under this contract, we have created and produced an innovative injectable product comprised of three anti-type A botulinum neurotoxin monoclonal antibodies to support entry into Phase 1 human clinical trials. This work was substantially complete as of December 31, 2009.

In September of 2008, we were awarded a third contract for \$65 million funded with federal funds from NIAID under Contract No. HHSN272200800028C to continue development of our anti-botulinum antibody product candidates, including XOMA 3AB and additional product candidates. As part of the contract, we will develop, evaluate and produce the clinical supplies to support an IND filing with the FDA and conduct preclinical studies required to support human clinical trials.

### ***SRI International***

In the third quarter of 2009, we began work on two biodefense subcontract awards from SRI International, including a \$1.7 million award to develop novel antibody drugs against the virus that causes severe acute respiratory syndrome and a \$2.2 million award to develop a novel antibody, known as F10, that has been shown to neutralize group 1 influenza A viruses, including the H1N1 and H5N1 strains. The subcontract awards are funded through NIAID.

### ***Novartis***

In November of 2008, we restructured our product development collaboration with Novartis, which involves six development programs including the HCD122 program. HCD122, which is a fully human anti-CD40 antagonist antibody intended as a treatment for B-cell mediated diseases, including malignancies and autoimmune diseases, is currently recruiting patients for a Phase 1/2 lymphoma trial. The antibody has a dual mechanism of action that involves inhibition of CD40-ligand mediated growth and survival while recruiting immune effector cells to kill CD40-expressing tumor cells through a process known as antibody-dependent cellular cytotoxicity (ADCC). CD40, a member of the tumor necrosis factor, or TNF, family of antigens, is a cell surface antigen expressed in B-cell malignancies and involved in a broad variety of immune and inflammatory responses.

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Under the restructured agreement, Novartis made a payment to us of \$6.2 million in cash; reduced our existing debt by \$7.5 million; will fully fund all future research and development expenses; may pay potential milestones of up to \$14 million and double-digit royalty rates for two ongoing product programs, including HCD122; and has provided us with options to develop or receive royalties on four additional programs. In exchange, Novartis has control over the HCD122 program and the additional ongoing program, as well as the right to expand the development of these programs into additional indications outside of oncology. As part of the agreement, Novartis paid us for all project costs incurred after July 1, 2008.

The collaboration between XOMA and Novartis (then Chiron Corporation) began in 2004 with the signing of an exclusive, worldwide, multi-product agreement to develop and commercialize multiple antibody products for the treatment of cancer. We shared expenses and revenue, generally on a 70-30 basis, with our share being 30 percent. Financial terms included initial payments to us in 2004 totaling \$10 million and a note agreement, secured by our interest in the collaboration, to fund up to 75 percent of our share of expenses beginning in 2005. The secured note agreement with Novartis, which was executed in May of 2005, is due and payable in full in June of 2015. At December 31, 2009, the outstanding principal balance under this note agreement totaled \$13.3 million and, pursuant to the terms of the arrangement as restructured in November of 2008, we will not make any additional borrowings on the Novartis note. In the first quarter of 2007, the mutual obligations of XOMA and Novartis to work together on an exclusive basis in oncology expired, except with respect to existing collaborative product development projects.

In December of 2008, we entered into a Manufacturing and Technology Transfer Agreement with Novartis, effective July 1, 2008. Under this agreement, XOMA was engaged by Novartis to perform research and development, process development, manufacturing and technology transfer activities with respect to the ongoing product programs now controlled by Novartis under the restructured product development collaboration. The work performed by XOMA under this agreement, which was fully funded by Novartis, was completed in the third quarter of 2009.

### ***Merck/Schering-Plough***

In May of 2006, we entered into a fully funded collaboration agreement with Merck/Schering-Plough for therapeutic monoclonal antibody discovery and development. Under the agreement, Merck/Schering-Plough will make up-front, annual maintenance and milestone payments to us, fund our research and development activities related to the agreement and pay royalties on sales of products resulting from the collaboration. During the collaboration, we will discover therapeutic antibodies against multiple targets selected by Merck/Schering-Plough using multiple human antibody phage display libraries, may optimize antibodies through affinity maturation or other protein engineering, may use our proprietary Human Engineering™ technology to humanize antibody candidates generated by hybridoma techniques, perform preclinical studies to support regulatory filings, develop cell lines and production processes and produce antibodies for initial clinical trials. Merck/Schering-Plough selected the first target at the inception of the agreement and, in December of 2006, exercised its right to initiate the additional discovery and development programs.

In the second quarter of 2009, we successfully completed the agreed-upon activities of certain programs under the collaboration and transferred these programs to Merck/Schering-Plough for continued development. As a result, the number of discovery and development programs under this collaboration was reduced. This resulted in the recognition of \$2.6 million in May of 2009 of the remaining unamortized balance in deferred revenue pertaining to these transferred programs.

### ***Merck/Schering-Plough/AVEO Pharmaceuticals, Inc. ("AVEO")***

In April of 2006, we entered into an agreement with AVEO to utilize our Human Engineering™ technology to humanize AV-299, AVEO's novel anti-HGF antibody, under which AVEO paid us an up-front license fee and

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development milestones. In addition, we will receive royalties on sales of products resulting from the agreement. Under this agreement we created four Human Engineering™ versions of the original AV-299, all of which met design goals and from which AVEO selected one as its lead development candidate. In September of 2006, as a result of the successful humanization of AV-299, we entered into a second agreement with AVEO to manufacture and supply AV-299 in support of early clinical trials. Under the agreement, we created AV-299 production cell lines, conducted process and assay development, and performed Good Manufacturing Practices (“cGMP”) manufacturing activities. AVEO retains all development and commercialization rights to AV-299 and may be required to pay XOMA annual maintenance fees, additional development milestones and royalties in the future.

In April of 2007, Merck/Schering-Plough entered into a research, development and license agreement with AVEO concerning AV-299 and other anti-HGF molecules. In connection with the aforementioned license agreement, AVEO has assigned its entire right, title and interest in, to and under its manufacturing agreement with XOMA to Merck/Schering-Plough. Revenue related to this contract declined in 2009 as a result of our nearing the end of the contracted service arrangement.

### ***UCB***

Celltech Therapeutics Ltd., now UCB Celltech, a branch of UCB, utilized our bacterial cell expression technology under license in the development of CIMZIA® for the treatment of moderate-to-severe Crohn’s disease in adults who have not responded to conventional therapies and for the treatment of moderate-to-severe rheumatoid arthritis in adults. We are entitled to receive a low-single digit royalty on sales of CIMZIA® in countries where our bacterial cell expression technology is patented, which includes the U.S. and Canada. CIMZIA® was approved by the FDA in April of 2008 for the treatment of Crohn’s disease and in May of 2009 for the treatment of rheumatoid arthritis. CIMZIA® was approved in Canada for the treatment of moderate-to-severe rheumatoid arthritis in adults in September of 2009.

### ***Genentech***

In April of 1996, we entered into a collaboration agreement with Genentech for the development of RAPTIVA®. In March of 2003, we entered into amended agreements which called for us to share in the development costs and called for Genentech to finance our share of development costs via a convertible subordinated loan. Under the loan agreement, upon FDA approval of the product, which occurred in October of 2003, we elected to pay \$29.6 million of the development loan in convertible preference shares, which are convertible into approximately 3.8 million common shares at a price of \$7.75 per common share.

In January of 2005, we restructured our arrangement with Genentech on RAPTIVA® under which we were entitled to receive mid-single digit royalties on worldwide sales of RAPTIVA® in all indications. The previous cost and profit sharing arrangement for RAPTIVA® in the U.S. was discontinued and Genentech was responsible for all operating and development costs associated with the product. In the first half of 2009, RAPTIVA® was withdrawn from the commercial drug markets and royalties ceased.

Genentech utilized our bacterial cell expression technology under license in the development of LUCENTIS® for the treatment of neovascular wet age-related macular degeneration. LUCENTIS® was approved by the FDA in June of 2006 and in the European Union in January of 2007. We were entitled to receive a low-single digit royalty on worldwide sales of LUCENTIS®. In the third quarter of 2009, we sold our LUCENTIS® royalty interest to Genentech for \$25 million, including royalty revenue from the second quarter of 2009. We will not receive any further royalties from sales of LUCENTIS®.

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### ***Equity Agreements***

In May of 2009, we entered into a definitive agreement with an institutional investor to sell 11,764,706 units, with each unit consisting of one of our common shares and a warrant to purchase 0.50 of a common share, for gross proceeds of approximately \$10 million, before deducting placement agent fees and estimated offering expenses of \$0.8 million, in a registered direct offering. The investor purchased the units at a price of \$0.85 per unit. The warrants, which represent the right to acquire an aggregate of up to 5,882,353 common shares, were exercisable at any time on or after May 15, 2009 and prior to May 20, 2014 at an exercise price of \$1.02 per share. As of December 31, 2009, all warrants issued in May of 2009 remained outstanding. Refer to *Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations: Subsequent Events* for disclosure regarding certain amendments made to the terms of the warrants issued in May of 2009 and the number of shares issued upon exercise of these warrants subsequent to the end of 2009.

In June of 2009, we entered into a definitive agreement with certain institutional investors to sell 10,434,782 units, with each unit consisting of one of our common shares and a warrant to purchase 0.50 of a common share, for gross proceeds of approximately \$12 million, before deducting placement agent fees and estimated offering expenses of \$0.8 million, in a second registered direct offering. The investor purchased the units at a price of \$1.15 per unit. The warrants, which represent the right to acquire an aggregate of up to 5,217,391 common shares, are exercisable at any time on or prior to December 10, 2014 at an exercise price of \$1.30 per share. As of December 31, 2009, all warrants issued in June of 2009 remained outstanding. Refer to *Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations: Subsequent Events* for disclosure regarding certain amendments made to the terms of the warrants issued in June of 2009 subsequent to the end of 2009.

In the third quarter of 2009, we entered into an At Market Issuance Sales Agreement (the "ATM Agreement"), with Wm Smith & Co. ("Wm Smith"), under which we may sell up to 25 million of our common shares from time to time through Wm Smith, as the agent for the offer and sale of the common shares. Wm Smith may sell these common shares by any method permitted by law deemed to be an "at the market" offering as defined in Rule 415 of the Securities Act of 1933, including but not limited to sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. Wm Smith may also sell the common shares in privately negotiated transactions, subject to our approval. We pay Wm Smith a commission equal to 3% of the gross proceeds of all common shares sold through it as sales agent under the ATM Agreement but in no event less than \$0.02 per share. Shares sold under the ATM Agreement are sold pursuant to a prospectus which forms a part of a registration statement declared effective by the Securities and Exchange Commission on May 29, 2008. From the inception of the ATM Agreement through December 31, 2009, we sold a total of 4,050,617 common shares under this agreement for aggregate gross proceeds of \$2.9 million. Refer to *Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations: Subsequent Events* for disclosure regarding the number common shares sold under this agreement subsequent to the end of 2009.

### ***Recently Terminated Agreements***

#### ***Goldman Sachs Term Loan***

In September of 2009, we fully repaid our term loan facility with Goldman Sachs, which was a five-year term loan facility originally entered into in November of 2006 and refinanced in May of 2008. As previously disclosed, we were not in compliance with the requirements of the relevant provisions of this loan facility, due to the cessation of royalties from sales of RAPTIVA®. Repayment of this loan facility discharged all of our obligations to the lenders.

We repaid the outstanding principal balance of \$42 million, accrued interest to the date of payment of \$2.4 million and a prepayment premium of \$2.5 million. In the third quarter of 2009, we recorded a loss on repayment of debt of \$3.6 million, which included the prepayment premium and the recognition of unamortized debt issuance costs of \$1.1 million.

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### ***Equity Line of Credit***

In October of 2008, we entered into a common share purchase agreement (the “Purchase Agreement”) with Azimuth Opportunity Ltd. (“Azimuth”), pursuant to which we obtained a committed equity line of credit facility (the “Facility”) under which we could sell up to \$60 million of our registered common shares to Azimuth over a 24-month period, subject to certain conditions and limitations. Shares under the Facility were sold pursuant to a prospectus which forms a part of a registration statement declared effective by the Securities and Exchange Commission on May 29, 2008. At the end of the third quarter of 2009, the Facility was no longer in effect, and no additional shares can be issued thereunder. From the inception of the Facility through 2009, we sold a total of 42,228,428 common shares to Azimuth for aggregate gross proceeds of \$33.9 million. This included the sale of 34.3 million shares in two transactions in September of 2009 that Azimuth agreed to purchase notwithstanding that the purchase prices were below the minimum price of \$1.00 required by the Purchase Agreement. We negotiated a discount rate (excluding placement agent fees) of 8.0% for those transactions. Prior to the successful conclusion of negotiations, Azimuth was not obligated to purchase these shares. Offering expenses incurred in 2009 related to sales to Azimuth were \$0.4 million.

### **Research and Development**

Our research and development expenses currently include costs of personnel, supplies, facilities and equipment, consultants, third party costs and other expenses related to preclinical and clinical testing. In 2009, our research and development expenses were \$58.1 million compared with \$82.6 million in 2008 and \$66.2 million in 2007.

Our research and development activities can be divided into those related to our internal projects and those related to collaborative and contract arrangements, which are reimbursed by our customers. In 2009, research and development expenses related to internal projects were \$42.2 million compared with \$58.5 million in 2008 and \$45.8 million in 2007. In 2009, research and development expenses related to collaborative and contract arrangements were \$15.9 million compared with \$24.1 million in 2008 and \$20.4 million in 2007. Refer to *Item 7: Management’s Discussion and Analysis of Financial Condition and Results of Operations—Research and Development Expenses* for further information regarding our research and development expenses.

### **Competition**

The biotechnology and pharmaceutical industries are subject to continuous and substantial technological change. Competition in the areas of recombinant DNA-based and antibody-based technologies is intense and expected to increase as new technologies emerge and established biotechnology firms and large chemical and pharmaceutical companies continue to advance in the field. A number of these large pharmaceutical and chemical companies have enhanced their capabilities by entering into arrangements with or acquiring biotechnology companies or entering into business combinations with other large pharmaceutical companies. Many of these companies have significantly greater financial resources, larger research and development and marketing staffs and larger production facilities than ours. Moreover, certain of these companies have extensive experience in undertaking preclinical testing and human clinical trials. These factors may enable other companies to develop products and processes competitive with or superior to ours. In addition, a significant amount of research in biotechnology is being carried out in universities and other non-profit research organizations. These entities are becoming increasingly interested in the commercial value of their work and may become more aggressive in seeking patent protection and licensing arrangements. Furthermore, many companies and universities tend not to announce or disclose important discoveries or development programs until their patent position is secure or, for other reasons, later. As a result, we may not be able to track development of competitive products, particularly at the early stages. There can be no assurance that developments by others will not render our products or technologies obsolete or uncompetitive.

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Without limiting the foregoing, we are aware of the following competitors for the products and candidates shown in the table below. This table is not intended to be representative of all existing competitors in the market:

<u>Product/Candidate</u>	<u>Competitors</u>
<b>XOMA 052</b>	Amgen, Inc. Biovitrum AB Cytos Biotechnology AG Eli Lilly and Company Novartis AG Regeneron Pharmaceuticals, Inc.
<b>XOMA 3AB</b>	Cangene Corporation Emergent BioSolutions, Inc.
<b>CIMZIA®</b>	Abbott Laboratories Amgen, Inc. Johnson & Johnson

## **Regulatory**

Our products are subject to comprehensive preclinical and clinical testing requirements and to approval processes by the FDA and by similar authorities in other countries. Our products are primarily regulated on a product-by-product basis under the United States Food, Drug and Cosmetic Act and Section 351(a) of the Public Health Service Act. Most of our human therapeutic products are or will be classified as biologic products. Approval of a biologic for commercialization requires licensure of the product and the manufacturing facilities. The review of therapeutic biologic products is carried out by the FDA's Center for Drug Evaluation and Research, the body that also reviews drug products.

The FDA regulatory process is carried out in several phases. Prior to beginning human clinical testing of a proposed new biologic product, an IND is filed with the FDA. This document contains scientific information on the proposed product, including results of testing of the product in animal and laboratory models. Also included is information on manufacturing the product and studies on toxicity in animals and a clinical protocol outlining the initial investigation in humans.

The initial stage of clinical testing, Phase 1, ordinarily encompasses safety, pharmacokinetic and pharmacodynamic evaluations. Phase 2 testing encompasses investigation in specific disease states designed to provide preliminary efficacy data and additional information on safety. Phase 3 studies are designed to further establish clinical safety and efficacy and to provide information allowing proper labeling of the product following approval. Phase 3 studies are most commonly multi-center, randomized, placebo-controlled trials in which rigorous statistical methodology is applied to clinical results. Other designs may also be appropriate in specific circumstances.

Following completion of clinical trials, a BLA is submitted to the FDA to request marketing approval. Internal FDA committees are formed that evaluate the application, including scientific background information, animal and laboratory efficacy studies, toxicology, manufacturing facility and clinical data. During the review process, a dialogue between the FDA and the applicant is established in which FDA questions are raised and additional information is submitted. During the final stages of the approval process, the FDA generally requests presentation of clinical or other data before an FDA advisory committee, at which point, some or all of such data may become available. Also, during the later stages of review, the FDA conducts an inspection of the manufacturing facility to establish that the product is made in conformity with good manufacturing practice. If all outstanding issues are satisfactorily resolved and labeling established, the FDA issues a license for the product and for the manufacturing facility, thereby authorizing commercial distribution.

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The FDA has substantial discretion in both the product approval process and the manufacturing approval process. It is not possible to predict at what point, or whether, the FDA will be satisfied with our submissions or whether the FDA will raise questions which may delay or preclude product approval or manufacturing facility approval. As additional clinical data is accumulated, it will be submitted to the FDA and may have a material impact on the FDA product approval process. Given that regulatory review is an interactive and continuous process, we have adopted a policy of limiting announcements and comments upon the specific details of the ongoing regulatory review of our products, subject to our obligations under the securities laws, until definitive action is taken. There can be no assurance any of the products we have under development will be developed successfully, obtain the requisite regulatory approval or be successfully manufactured or marketed.

In Europe, most of our human therapeutic products are or will be classified as biological medicinal products which are assessed through a centralized procedure by the European Medicines Agency (“EMA”). The EMA coordinates the evaluation and supervision of medicinal products throughout the European Union and the European Economic Area. The assessment of the Marketing Authorization Application (“MA”) is carried out by a Rapporteur and a Co-Rapporteur appointed by the Committee for Medicinal Products for Human Use (“CHMP”), which is the expert scientific committee of the EMA.

The Rapporteur and Co-Rapporteur are drawn from the CHMP membership representing member states of the European Union. In addition to their responsibility for undertaking scientific assessments of an application for a MA, the Rapporteur and the Co-Rapporteur liaise with the applicant on behalf of the CHMP in an effort to provide answers to queries raised by the CHMP. Their assessment report(s) is circulated to and considered by the full CHMP membership, leading to the production ultimately of a CHMP opinion which is transmitted to the applicant and the European Commission. The final decision on the grant of a MA is made by the European Commission as the licensing authority of the European Community (“Community”). Under Community law, a positive decision issued by the European Commission represents the grant of a MA. Such an authorization allows a medicinal product to be placed on the European market. Upon the grant of an MA in the European Union, certain member states require pricing approval before the product can be placed into commercial distribution.

Under Community law, the applicant may request grant of a MA under exceptional circumstances if comprehensive data on the efficacy and safety of the drug, under normal conditions of use cannot be provided because its intended indications are encountered so rarely (such as in the case of a medicinal product intended for treating an orphan disease) that comprehensive evidence cannot reasonably be collected, the present state of scientific knowledge will not allow comprehensive information to be collected, or it would be against generally accepted medical ethics to collect comprehensive information. The Rapporteur, Co-Rapporteur and the other CHMP members will assess the justification/data submitted for exceptional circumstances as part of the overall assessment of the benefit/risk of the application. It is up to the CHMP, during the review, to ultimately decide on whether grant of a MA under exceptional circumstances is justified on the evidence before them. Approval under exceptional circumstances is subject to a requirement for specific procedures related to safety and results of its use and is reviewed annually to reassess the risk-benefit balance of the product. Once approval is granted, the product can be marketed under the single European MA in all member states of the European Union and the European Economic Area. Consistent with the single MA, the labeling for Europe is identical throughout all member states except that all labeling must be translated into the local language of the country of intended importation and in relation to the content of the so called “blue box” on the outer packaging in which locally required information may be inserted.

Orphan drugs are those intended for use in rare diseases or conditions. As a result of the high cost of development and the low return on investment for rare diseases, governments provide regulatory and commercial incentives for the development of drugs for small disease populations. In the United States, the term “rare disease or condition” means any disease or condition which affects less than 200,000 persons in the United States. Applications for United States orphan drug status are evaluated and granted by the Office of Orphan Products Development (“OOPD”) of the FDA. In the United States, orphan drugs are subject to the standard regulatory process for marketing approval but are exempt from the payment of user fees for licensure, receive market exclusivity for a period of seven years and some tax benefits, and are eligible for OOPD grants. In

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Europe, orphan medicinal products are those intended for the diagnosis, prevention or treatment of a life-threatening or chronically debilitating condition affecting not more than five in 10,000 persons in the Community. The EMEA's Committee for Orphan Medicinal Products ("COMP") reviews applications seeking orphan designation. If the European Commission agrees with a positive assessment made by COMP, then the product will receive a positive designation through adoption of a decision by the European Commission. Orphan medicinal products are exempt from fees for protocol assistance and scientific advice from the Scientific Advice Working Party during development, reduction or exemption of MA and other fees, and ten-year market exclusivity upon granting of a MA in respect of the approved clinical indication. Moreover, manufacturers may be eligible for grants or other financial incentives from the Community and Member States programs.

### **Patents and Trade Secrets**

Patent and trade secret protection is important to our business and our future will depend in part on our ability to obtain patents, maintain trade secret protection and operate without infringing on the proprietary rights of others. As a result of our ongoing activities, we hold and have filed applications for a number of patents in the United States and internationally to protect our products and important processes. We also have obtained or have the right to obtain exclusive licenses to certain patents and applications filed by others. However, the patent position of biotechnology companies generally is highly uncertain and no consistent policy regarding the breadth of allowed claims has emerged from the actions of the U.S. Patent and Trademark Office ("Patent Office") with respect to biotechnology patents. Accordingly, no assurance can be given that our patents will afford protection against competitors with similar technologies, or others will not obtain patents claiming aspects similar to those covered by our patent applications.

We have established a portfolio of patents related to our bacterial expression technology, including claims to novel promoter sequences, secretion signal sequences, compositions, methods for expression and secretion of recombinant proteins from bacteria, including immunoglobulin gene products, and improved methods and cells for expression of recombinant protein products. U.S. Patent Nos. 5,576,195 and 5,846,818 are related to DNA encoding a pectate lyase signal sequence, recombinant vectors, host cells and methods for production and externalization of recombinant proteins. U.S. Patent Nos. 5,595,898, 5,698,435 and 5,618,920 address secretable immunoglobulin chains, DNA encoding the chains and methods for their recombinant production. U.S. Patent Nos. 5,693,493, 5,698,417 and 6,204,023 relate to methods for recombinant production/secretion of functional immunoglobulin molecules. U.S. Patent Nos. 7,094,579 and 7,396,661 relate to eukaryotic signal sequences and their use in methods for prokaryotic expression of recombinant proteins. U.S. Patent No. 6,803,210 relates to improved bacterial host cells that are deficient in one or more of the active transport systems for an inducer of an inducible promoter, such as arabinose for an araB promoter, and methods for the use of such cells for the production of recombinant proteins. Most of the more important European patents in this portfolio expired in July of 2008 or earlier.

We have also established a portfolio of patent applications related to our mammalian expression technology, including U.S. Patent No. 7,192,737, related to methods for increasing the expression of recombinant polypeptides using expression vectors containing multiple copies of a transcription unit encoding a polypeptide of interest.

We have established a portfolio of patents and applications related to our Human Engineering™ technology, including U.S. Patent No. 5,766,886, directed to methods of modifying antibody variable domains to reduce immunogenicity. Related patents and applications are directed to antibodies engineered according to our patented methods. We believe that our patented Human Engineering™ technology provides an attractive alternative to other humanization technologies.

We also have issued patents in the U.S. and Europe covering XOMA 052. In May and September of 2009, the U.S. Patent and Trademark Office issued U.S. Patents 7,531,166 and 7,582,742, respectively, covering XOMA 052 and other antibodies and antibody fragments with similar binding properties for IL-1 beta, as well as nucleic acids, expression vectors and production cell lines for the manufacture of such antibodies and antibody

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fragments. The patents provide exclusivity in the U.S. into 2027 and 2026, respectively. In November of 2009, the European Patent Office granted a patent covering XOMA 052, as well as nucleic acids, expression vectors and production cell lines for the manufacture of XOMA 052. The patent provides exclusivity in Europe into 2026.

If certain patents issued to others are upheld or if certain patent applications filed by others issue and are upheld, we may require certain licenses from others in order to develop and commercialize certain potential products incorporating our technology. There can be no assurance that such licenses, if required, will be available on acceptable terms.

Where appropriate, we also rely on trade secrets to protect aspects of our technology. However, trade secrets are difficult to protect. We protect our proprietary technology and processes, in part, by confidentiality agreements with our employees, consultants and collaborators. These parties may breach these agreements, and we may not have adequate remedies for any breach. Our trade secrets may otherwise become known or be independently discovered by competitors. To the extent that we or our consultants or collaborators use intellectual property owned by others, we may have disputes with our collaborators or consultants or other third parties as to the rights in related or resulting know-how and inventions.

### **International Operations**

We believe that, because the pharmaceutical industry is global in nature, international activities will be a significant part of our future business activities and that, when and if we are able to generate income, a substantial portion of that income will be derived from product sales and other activities outside the United States.

A number of risks are inherent in international operations. Foreign regulatory agencies often establish standards different from those in the United States. An inability to obtain foreign regulatory approvals on a timely basis could have an adverse effect on our international business, financial condition and results of operations. International operations may be limited or disrupted by the imposition of government controls, export license requirements, political or economic instability, trade restrictions, changes in tariffs, restrictions on repatriating profits, taxation or difficulties in staffing and managing international operations. In addition, our business, financial condition and results of operations may be adversely affected by fluctuations in currency exchange rates. There can be no assurance that we will be able to successfully operate in any foreign market.

Financial information regarding the geographic areas in which we operate is included in *Note 13 to the Financial Statements: Concentration of Risk, Segment and Geographic Information*.

### **Concentration of Risk**

In 2009, Takeda and Genentech each provided more than 10% of our total revenue, neither of which represents a related party to XOMA. These key customers accounted for 65% of our total revenue in 2009 but were not responsible for any of the accounts receivable balance at December 31, 2009. NIAID, Arana and Kaketsuken accounted for 90% of the accounts receivable balance at December 31, 2009. The loss of one or more of these customers could have a material adverse effect on our business and financial condition.

In 2008, Genentech, Novartis and Merck/Schering-Plough each provided more than 10% of our total revenue, none of which represents a related party to XOMA. These key customers accounted for 81% of our total revenue in 2008 and represented 64% of the accounts receivable balance at December 31, 2008. NIAID accounted for an additional 28% of the accounts receivable balance at December 31, 2008. In 2007, Pfizer, Genentech, Merck/Schering-Plough and NIAID each provided more than 10% of our total revenue, none of which represent a related party to XOMA.

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### **Organization**

We were incorporated in Delaware in 1981 and became a Bermuda company effective December 31, 1998, when we completed a shareholder-approved corporate reorganization, changing our legal domicile from Delaware to Bermuda and our name to XOMA Ltd. When referring to a time or period before December 31, 1998, or when the context so requires, the terms “Company” and “XOMA” refer to XOMA Corporation, a Delaware corporation and the predecessor of XOMA Ltd.

### **Employees**

As of March 9, 2010, we employed approximately 195 full-time employees (none of which are unionized) at our facilities, principally in Berkeley, California. Our employees are primarily engaged in clinical, process development, research and product development, and in executive, business development, finance and administrative positions. We consider our employee relations to be excellent.

### **Available Information**

For information on XOMA’s investment prospects and risks, please contact Investor Relations and Corporate Communications at (800) 246-9662 or by sending an e-mail message to [investorrelations@xoma.com](mailto:investorrelations@xoma.com). Our principal executive offices are located at 2910 Seventh Street, Berkeley, California 94710, U.S.A. Our telephone number is (510) 204-7200.

The following information can be found on our website at <http://www.xoma.com> or can be obtained free of charge by contacting our Investor Relations Department:

- Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports will be available as soon as reasonably practicable after such material is electronically filed with the United States Securities and Exchange Commission (“SEC”). All reports we file with the SEC can also be obtained free of charge via EDGAR through the SEC’s website at <http://www.sec.gov>.
- Our policies related to corporate governance, including our Code of Ethics applying to our directors, officers and employees (including our principal executive officer and principal financial and accounting officer) that we have adopted to meet the requirements set forth in the rules and regulations of the SEC and its corporate governance principles are available.
- The charters of the Audit, Compensation and Nominating & Governance Committees of our Board of Directors are available.

We intend to satisfy the applicable disclosure requirements regarding amendments to, or waivers from, provisions of our Code of Ethics by posting such information on our website.

### **Item 1A. Risk Factors**

The following risk factors and other information included in this annual report should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us also may impair our business operations. If any of the following risks occur, our business, financial condition, operating results and cash flows could be materially adversely affected.

**Because our product candidates are still being developed, we will require substantial funds to continue; we cannot be certain that funds will be available and, if they are not available, we may have to take actions that could adversely affect your investment and may not be able to continue as a going concern.**

While our refocused business strategy has reduced capital expenditures and other operating expenses, we will need to commit substantial funds to continue development of our product candidates and we may not be able to obtain sufficient funds on acceptable terms, or at all. If adequate funds are not available, we may have to raise additional funds in a manner that may dilute or otherwise adversely affect the rights of existing shareholders,

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curtail or cease operations, or file for bankruptcy protection in extreme circumstances. We have spent, and we expect to continue to spend, substantial funds in connection with:

- research and development relating to our product candidates and production technologies,
- various human clinical trials, and
- protection of our intellectual property.

We finance our operations primarily through our multiple revenue streams resulting from the licensing of our antibody technologies, discovery and development collaborations, product royalties and biodefense contracts, and sales of our common shares. In September of 2009, we sold our royalty interest in LUCENTIS® to Genentech, Inc., a wholly-owned member of the Roche Group (referred to herein as “Genentech”) for gross proceeds of \$25 million, including royalty revenue from the second quarter of 2009. These proceeds, along with other funds, were used to fully repay our loan from Goldman Sachs Specialty Lending Holdings, Inc. (“Goldman Sachs”). As a result, we no longer have a royalty interest in LUCENTIS®. In 2008, we received \$8.8 million of revenue from this royalty interest.

Based on our cash reserves and anticipated spending levels, revenue from collaborations including a XOMA 052 corporate partnership, licensing transactions or biodefense contracts and other sources of funding we believe to be available, we believe that we have sufficient cash resources to meet our anticipated net cash needs through the next twelve months. Any significant revenue shortfalls, increases in planned spending on development programs or more rapid progress of development programs than anticipated, as well as the unavailability of anticipated sources of funding, could shorten this period. If adequate funds are not available, we will be required to delay, reduce the scope of, or eliminate one or more of our product development programs and further reduce personnel-related costs. Progress or setbacks by potentially competing products may also affect our ability to raise new funding on acceptable terms. As a result, we do not know when or whether:

- operations will generate meaningful funds,
- additional agreements for product development funding can be reached,
- strategic alliances can be negotiated, or
- adequate additional financing will be available for us to finance our own development on acceptable terms, or at all.

Cash balances and operating cash flow are influenced primarily by the timing and level of payments by our licensees and development partners, as well as by our operating costs.

### **Global credit and financial market conditions may reduce our ability to access capital and cash and could negatively impact the value of our current portfolio of cash equivalents or short-term investments and our ability to meet our financing objectives.**

Traditionally, we have funded a large portion of our research and development expenditures through raising capital in the equity markets. Recent events, including failures and bankruptcies among large commercial and investment banks, have led to considerable declines and uncertainties in these and other capital markets and may lead to new regulatory and other restrictions that may broadly affect the nature of these markets. These circumstances could severely restrict the raising of new capital by companies such as us in the future.

Recent volatility in the financial markets has also created liquidity problems in investments previously thought to bear a minimal risk. For example, money market fund investors, including us, have in the past been unable to retrieve the full amount of funds, even in highly-rated liquid money market accounts, upon maturity. Although as of December 31, 2009, we have received the full amount of proceeds from money market fund investments, an inability to retrieve funds from money market and similar short-term investments as they mature in the future could have a material and adverse impact on our business, results of operations and cash flows.

Our cash and cash equivalents are maintained in highly liquid investments with remaining maturities of 90 days or less at the time of purchase. Our short-term investments consist primarily of readily marketable debt

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securities with remaining maturities of more than 90 days at the time of purchase. While as of the date of this filing, we are not aware of any downgrades, material losses, or other significant deterioration in the fair value of our cash equivalents or short-term investments since December 31, 2009, no assurance can be given that further deterioration in conditions of the global credit and financial markets would not negatively impact our current portfolio of cash equivalents or short-term investments or our ability to meet our financing objectives.

**If the trading price of our common shares fails to comply with the continued listing requirements of The NASDAQ Global Market, we would face possible delisting, which would result in a limited public market for our common shares and make obtaining future debt or equity financing more difficult for us.**

Companies listed on The NASDAQ Stock Market (“NASDAQ”) are subject to delisting for, among other things, failure to maintain a minimum closing bid price per share of \$1.00 for 30 consecutive business days. The closing price per share of our common shares has been below \$1.00 for all but eight days since December 9, 2008. Although NASDAQ temporarily suspended the minimum bid price requirement in response to market conditions, this suspension expired on July 31, 2009.

On September 21, 2009, we received a letter from NASDAQ indicating that for the 30 consecutive business days preceding September 15, 2009, the bid price of our common shares closed below the minimum \$1.00 per share requirement pursuant to NASDAQ Listing Rule 5450(a)(1) for continued inclusion on The NASDAQ Global Market. In accordance with NASDAQ Listing Rule 5810(c)(3)(A), we have a period of 180 calendar days, or until March 15, 2010, to regain compliance with the minimum bid price requirement. We anticipate receiving a further letter from NASDAQ on or shortly after March 16, 2010 indicating that we have not regained compliance with this requirement and intend to request a hearing before a NASDAQ Listing Qualification Panel (the “Panel”), which request will stay delisting pending the Panel’s decision following the hearing. At the hearing, we intend to request continued listing based on a plan for regaining compliance. Although the Panel has authority to grant us up to an additional 180 days from the date of the forthcoming NASDAQ notice to implement our plan, there can be no assurance that the Panel will grant our request for continued listing. Furthermore, we cannot be sure that our share price will comply with the requirements for continued listing of our common shares on The NASDAQ Global Market in the future. If our common shares lose their status on The NASDAQ Global Market and we are not successful in obtaining a listing on The NASDAQ Capital Market, our common shares would likely trade in the over-the-counter market.

If our shares were to trade on the over-the-counter market, selling our common shares could be more difficult because smaller quantities of shares would likely be bought and sold, transactions could be delayed, and security analysts’ coverage of us may be reduced. In addition, in the event our common shares are delisted, broker-dealers have certain regulatory burdens imposed upon them, which may discourage broker-dealers from effecting transactions in our common shares, further limiting the liquidity thereof. These factors could result in lower prices and larger spreads in the bid and ask prices for common shares.

Such delisting from The NASDAQ Global Market or future declines in our share price could also greatly impair our ability to raise additional necessary capital through equity or debt financing, and could significantly increase the ownership dilution to shareholders caused by our issuing equity in financing or other transactions. Consent under the Exchange Control Act 1972 (and its related regulations) has been obtained from the Bermuda Monetary Authority for the issue and transfer of our shares, notes and other securities to and between non-residents of Bermuda for exchange control purposes, but this consent is conditional on our shares remaining listed on an appointed stock exchange. We cannot assure you that the Bermuda Monetary Authority will give the same or a similar consent in the event our common shares are no longer listed on The NASDAQ Global Market or another appointed stock exchange. In the absence of such a general consent, specific consents of the Bermuda Monetary Authority would be required for certain issues and transfers of our shares, notes and other securities.

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### **Because all of our product candidates are still being developed, we have sustained losses in the past and we expect to sustain losses in the future.**

We have experienced significant losses and, as of December 31, 2009, we had an accumulated deficit of \$784.6 million.

For the year ended December 31, 2009, we had net income of approximately \$0.6 million or \$0.00 per common share (basic and diluted). For the year ended December 31, 2008, we had a net loss of approximately \$45.2 million or \$0.34 per common share (basic and diluted).

Our ability to achieve profitability is dependent in large part on the success of our development programs, obtaining regulatory approval for our product candidates and entering into new agreements for product development, manufacturing and commercialization, all of which are uncertain. Our ability to fund our ongoing operations is dependent on the foregoing factors and on our ability to secure additional funds. Because our product candidates are still being developed, we do not know whether we will ever achieve sustained profitability or whether cash flow from future operations will be sufficient to meet our needs.

### **We may issue additional equity securities and thereby materially and adversely affect the price of our common shares.**

We are authorized to issue, without shareholder approval, 1,000,000 preference shares, of which 2,959 were issued and outstanding as of March 9, 2010, which may give other shareholders dividend, conversion, voting, and liquidation rights, among other rights, which may be superior to the rights of holders of our common shares. In addition, we are authorized to issue, generally without shareholder approval, up to 400,000,000 common shares, of which 203,042,194 were issued and outstanding as of December 31, 2009 and 261,191,984 were issued and outstanding as of March 9, 2010. If we issue additional equity securities, the price of our common shares may be materially and adversely affected.

As announced in the third quarter of 2009, we have entered into an At Market Issuance Sales Agreement, with Wm Smith & Co. (“Wm Smith”), under which we may sell up to 25 million of our common shares from time to time through Wm Smith, as the agent for the offer and sale of the common shares. Wm Smith may sell these common shares by any method permitted by law deemed to be an “at the market” offering as defined in Rule 415 of the Securities Act of 1933, including but not limited to sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. Wm Smith may also sell the common shares in privately negotiated transactions, subject to our approval. From the inception of this agreement through December 31, 2009, we sold a total of 4,050,617 common shares through Wm Smith for aggregate gross proceeds of \$2.9 million. Subsequent to December 31, 2009, we sold an additional 8,940,225 common shares through Wm Smith for aggregate gross proceeds of \$6.4 million.

In addition, on February 2, 2010, we entered into an underwritten offering with investors to sell 42 million units, with each unit consisting of one of our common shares and a warrant to purchase 0.45 of a common share, for gross proceeds of approximately \$21 million, before deducting underwriting discounts and commissions and estimated offering expenses of \$1.7 million. The investors purchased the units at a price of \$0.50 per unit. The warrants, which represent the right to acquire an aggregate of up to 18.9 million common shares, are exercisable beginning six months and one day after issuance and have a five-year term and an exercise price of \$0.70 per share.

### **The financial terms of future collaborative or licensing arrangements could result in dilution of our share value.**

Funding from collaboration partners and others has in the past and may in the future involve issuance by us of our shares. Because we do not currently have any such arrangements, we cannot be certain how the purchase price of such shares, the relevant market price or premium, if any, will be determined or when such determinations will be made. Any such issuance could result in dilution in the value of our issued and outstanding shares.

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### **Our share price may be volatile and there may not be an active trading market for our common shares.**

There can be no assurance that the market price of our common shares will not decline below its present market price or that there will be an active trading market for our common shares. The market prices of biotechnology companies have been and are likely to continue to be highly volatile. Fluctuations in our operating results and general market conditions for biotechnology stocks could have a significant impact on the volatility of our common share price. We have experienced significant volatility in the price of our common shares. From January 1, 2009 through March 9, 2010, our share price has ranged from a high of \$1.34 to a low of \$0.37. Factors contributing to such volatility include, but are not limited to:

- sales and estimated or forecasted sales of products for which we receive royalties,
- results of preclinical studies and clinical trials,
- information relating to the safety or efficacy of products or product candidates,
- developments regarding regulatory filings,
- announcements of new collaborations,
- failure to enter into collaborations,
- developments in existing collaborations,
- our funding requirements and the terms of our financing arrangements,
- technological innovations or new indications for our therapeutic products and product candidates,
- introduction of new products or technologies by us or our competitors,
- government regulations,
- developments in patent or other proprietary rights,
- the number of shares issued and outstanding,
- the number of shares trading on an average trading day,
- announcements regarding other participants in the biotechnology and pharmaceutical industries, and
- market speculation regarding any of the foregoing.

### **Our therapeutic product candidates have not received regulatory approval. If these product candidates do not receive regulatory approval, neither our third party collaborators nor we will be able to manufacture and market them.**

Our product candidates, including XOMA 052 and XOMA 3AB, cannot be manufactured and marketed in the United States and other countries without required regulatory approvals. The United States government and governments of other countries extensively regulate many aspects of our product candidates, including:

- testing,
- manufacturing,
- promotion and marketing, and
- exporting.

In the United States, the Food and Drug Administration (“FDA”) regulates pharmaceutical products under the Federal Food, Drug, and Cosmetic Act and other laws, including, in the case of biologics, the Public Health Service Act. At the present time, we believe that most of our product candidates will be regulated by the FDA as biologics. Initiation of clinical trials requires approval by health authorities. Clinical trials involve the administration of the investigational new drug to healthy volunteers or to patients under the supervision of a qualified principal investigator. Clinical trials must be conducted in accordance with FDA and International Conference on Harmonisation of Technical Requirements for Registration of Pharmaceuticals for Human Use Good Clinical Practices and the European Clinical Trials Directive under protocols that detail the objectives of

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the study, the parameters to be used to monitor safety and the efficacy criteria to be evaluated. Other national, foreign and local regulations may also apply. The developer of the drug must provide information relating to the characterization and controls of the product before administration to the patients participating in the clinical trials. This requires developing approved assays of the product to test before administration to the patient and during the conduct of the trial. In addition, developers of pharmaceutical products must provide periodic data regarding clinical trials to the FDA and other health authorities, and these health authorities may issue a clinical hold upon a trial if they do not believe, or cannot confirm, that the trial can be conducted without unreasonable risk to the trial participants. We cannot assure you that U.S. and foreign health authorities will not issue a clinical hold with respect to any of our clinical trials in the future.

The results of the preclinical studies and clinical testing, together with chemistry, manufacturing and controls information, are submitted to the FDA and other health authorities in the form of a new drug application for a pharmaceutical product, and in the form of a BLA for a biological product, requesting approval to commence commercial sales. In responding to a new drug application or an antibody license application, the FDA or foreign health authorities may grant marketing approvals, request additional information or further research, or deny the application if it determines that the application does not satisfy its regulatory approval criteria. Regulatory approval of a new drug application, BLA, or supplement is never guaranteed, and the approval process can take several years and is extremely expensive. The FDA and foreign health authorities have substantial discretion in the drug and biologics approval processes. Despite the time and expense incurred, failure can occur at any stage, and we could encounter problems that cause us to abandon clinical trials or to repeat or perform additional preclinical, clinical or manufacturing-related studies.

Changes in the regulatory approval policy during the development period, changes in, or the enactment of additional regulations or statutes, or changes in regulatory review for each submitted product application may cause delays in the approval or rejection of an application. State regulations may also affect our proposed products. The FDA has substantial discretion in both the product approval process and manufacturing facility approval process and, as a result of this discretion and uncertainties about outcomes of testing, we cannot predict at what point, or whether, the FDA will be satisfied with our or our collaborators' submissions or whether the FDA will raise questions which may be material and delay or preclude product approval or manufacturing facility approval. As we accumulate additional clinical data, we will submit it to the FDA, and such data may have a material impact on the FDA product approval process.

**Even once approved, a product may be subject to additional testing or significant marketing restrictions, its approval may be withdrawn or it may be voluntarily taken off the market.**

Even if the FDA, the European Commission or another regulatory agency approves a product candidate for marketing, the approval may impose ongoing requirements for post-approval studies, including additional research and development and clinical trials, and the FDA, European Commission or other regulatory agency may subsequently withdraw approval based on these additional trials.

Even for approved products, the FDA, European Commission or other regulatory agency may impose significant restrictions on the indicated uses, conditions for use, labeling, advertising, promotion, marketing and/or production of such product.

Furthermore, a marketing approval of a product may be withdrawn by the FDA, the European Commission or another regulatory agency or such a product may be voluntarily withdrawn by the company marketing it based, for example, on subsequently-arising safety concerns. In February of 2009, the European Medicines Agency ("EMA") announced that it had recommended suspension of the marketing authorization of RAPTIVA® in the European Union and that its Committee for Medicinal Products for Human Use ("CHMP") had concluded that the benefits of RAPTIVA® no longer outweigh its risks because of safety concerns, including the occurrence of progressive multifocal leukoencephalopathy ("PML") in patients taking the medicine. In the second quarter of 2009, Genentech announced and carried out a phased voluntary withdrawal of RAPTIVA® from the U.S. market, based on the association of RAPTIVA® with an increased risk of PML.

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The FDA, European Commission and other agencies also may impose various civil or criminal sanctions for failure to comply with regulatory requirements, including withdrawal of product approval.

### **We face uncertain results of clinical trials of our potential products.**

Our potential products, including XOMA 052 and XOMA 3AB, will require significant additional research and development, extensive preclinical studies and clinical trials and regulatory approval prior to any commercial sales. This process is lengthy and expensive, often taking a number of years. As clinical results are frequently susceptible to varying interpretations that may delay, limit or prevent regulatory approvals, the length of time necessary to complete clinical trials and to submit an application for marketing approval for a final decision by a regulatory authority varies significantly. As a result, it is uncertain whether:

- our future filings will be delayed,
- our preclinical and clinical studies will be successful,
- we will be successful in generating viable product candidates to targets,
- we will be able to provide necessary additional data,
- results of future clinical trials will justify further development, or
- we will ultimately achieve regulatory approval for any of these product candidates.

For example, in 2003, we completed two Phase 1 trials of XOMA 629, a BPI-derived topical peptide compound targeting acne, evaluating the safety, skin irritation and pharmacokinetics. In January of 2004, we announced the initiation of Phase 2 clinical testing in patients with mild-to-moderate acne. In August of 2004, we announced the results of a Phase 2 trial with XOMA 629 gel. The results were inconclusive in terms of clinical benefit of XOMA 629 compared with vehicle gel. In 2007, after completing an internal evaluation of this program, we chose to reformulate and focus development efforts on the use of this reformulated product candidate in superficial skin infections, including impetigo and the eradication of staphylococcus aureus. In the fourth quarter of 2008, we decided to curtail all spending on XOMA 629 in response to current economic conditions and to focus our financial resources on XOMA 052.

The timing of the commencement, continuation and completion of clinical trials may be subject to significant delays relating to various causes, including scheduling conflicts with participating clinicians and clinical institutions, difficulties in identifying and enrolling patients who meet trial eligibility criteria, and shortages of available drug supply. Patient enrollment is a function of many factors, including the size of the patient population, the proximity of patients to clinical sites, the eligibility criteria for the trial, the existence of competing clinical trials and the availability of alternative or new treatments. In addition, we will conduct clinical trials in foreign countries in the future which may subject us to further delays and expenses as a result of increased drug shipment costs, additional regulatory requirements and the engagement of foreign clinical research organizations, as well as expose us to risks associated with foreign currency transactions insofar as we might desire to use U.S. dollars to make contract payments denominated in the foreign currency where the trial is being conducted.

All of our product candidates are prone to the risks of failure inherent in drug development. Preclinical studies may not yield results that would satisfactorily support the filing of an IND (or a foreign equivalent) with respect to our product candidates. Even if these applications would be or have been filed with respect to our product candidates, the results of preclinical studies do not necessarily predict the results of clinical trials. Similarly, early-stage clinical trials in healthy volunteers do not predict the results of later-stage clinical trials, including the safety and efficacy profiles of any particular product candidates. In addition, there can be no assurance that the design of our clinical trials is focused on appropriate indications, patient populations, dosing regimens or other variables which will result in obtaining the desired efficacy data to support regulatory approval to commercialize the drug. Preclinical and clinical data can be interpreted in different ways. Accordingly, FDA officials or officials from foreign regulatory authorities could interpret the data in different ways than we or our partners do which could delay, limit or prevent regulatory approval.

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Administering any of our products or potential products may produce undesirable side effects, also known as adverse effects. Toxicities and adverse effects that we have observed in preclinical studies for some compounds in a particular research and development program may occur in preclinical studies or clinical trials of other compounds from the same program. Such toxicities or adverse effects could delay or prevent the filing of an IND (or a foreign equivalent) with respect to such products or potential products or cause us to cease clinical trials with respect to any drug candidate. In clinical trials, administering any of our products or product candidates to humans may produce adverse effects. These adverse effects could interrupt, delay or halt clinical trials of our products and product candidates and could result in the FDA or other regulatory authorities denying approval of our products or product candidates for any or all targeted indications. The FDA, other regulatory authorities, our partners or we may suspend or terminate clinical trials at any time. Even if one or more of our product candidates were approved for sale, the occurrence of even a limited number of toxicities or adverse effects when used in large populations may cause the FDA to impose restrictions on, or stop, the further marketing of such drugs. Indications of potential adverse effects or toxicities which may occur in clinical trials and which we believe are not significant during the course of such clinical trials may later turn out to actually constitute serious adverse effects or toxicities when a drug has been used in large populations or for extended periods of time. Any failure or significant delay in completing preclinical studies or clinical trials for our product candidates, or in receiving and maintaining regulatory approval for the sale of any drugs resulting from our product candidates, may severely harm our reputation and business.

Given that regulatory review is an interactive and continuous process, we maintain a policy of limiting announcements and comments upon the specific details of regulatory review of our product candidates, subject to our obligations under the securities laws, until definitive action is taken.

### **Certain of our technologies are relatively new and are in-licensed from third parties, so our capabilities using them are unproven and subject to additional risks.**

We license technologies from third parties. These technologies include but are not limited to phage display technologies licensed to us in connection with our bacterial cell expression technology licensing program. However, our experience with some of these technologies remains relatively limited and, to varying degrees, we are still dependent on the licensing parties for training and technical support for these technologies. In addition, our use of these technologies is limited by certain contractual provisions in the licenses relating to them and, although we have obtained numerous licenses, intellectual property rights in the area of phage display are particularly complex. If the owners of the patent rights underlying the technologies we license do not properly maintain or enforce those patents, our competitive position and business prospects could be harmed. Our success will depend in part on the ability of our licensors to obtain, maintain and enforce our licensed intellectual property. Our licensors may not successfully prosecute the patent applications to which we have licenses, or our licensors may fail to maintain existing patents. They may determine not to pursue litigation against other companies that are infringing these patents, or they may pursue such litigation less aggressively than we would. Our licensors may also seek to terminate our license, which could cause us to lose the right to use the licensed intellectual property and adversely affect our ability to commercialize our technologies, products or services.

### **To the extent our present and future revenue consist of royalties on product sales, our revenue will rely on sales of products marketed and sold by others.**

We have only a royalty interest in CIMZIA® and receive revenue from sales of CIMZIA® in the U.S. for the treatment of moderate-to-severe Crohn's disease and in the U.S. and Canada for the treatment of moderate-to-severe rheumatoid arthritis. CIMZIA® was approved in the United States in April of 2008 for the treatment of Crohn's disease. In May of 2009, CIMZIA® was approved by the FDA for the treatment of moderate-to-severe rheumatoid arthritis in adults and in Canada in September of 2009. UCB is responsible for the marketing and sales effort in support of this product. We have no role in marketing and sales efforts, and UCB does not have an express contractual obligation to us regarding the marketing or sales of CIMZIA®.

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Successful commercialization of CIMZIA® is subject to a number of risks, including, but not limited to:

- UCB's willingness and ability to implement their marketing and sales effort and achieve sales;
- the strength of competition from other products being marketed or developed to treat Crohn's disease and rheumatoid arthritis;
- the occurrence of adverse events which may give rise to safety concerns;
- physicians' and patients' acceptance of CIMZIA® as a treatment for Crohn's disease and rheumatoid arthritis;
- manufacturer's ability to provide manufacturing capacity to meet demand for the products;
- pricing and reimbursement issues; and
- expiration of patents and royalties.

### **We do not know whether there will be, or will continue to be, a viable market for the products in which we have an ownership or royalty interest.**

Although CIMZIA® was approved in the United States in April of 2008 for the treatment of Crohn's disease, and in the United States in May of 2009 and in Canada in September of 2009 for the treatment of rheumatoid arthritis, it may not be accepted in the marketplace. Furthermore, even if other products in which we have an interest receive approval in the future, they may not be accepted in the marketplace. In addition, we or our collaborators or licensees may experience difficulties in launching new products, many of which are novel and based on technologies that are unfamiliar to the healthcare community. We have no assurance that healthcare providers and patients will accept such products, if developed. For example, physicians and/or patients may not accept a product for a particular indication because it has been biologically derived (and not discovered and developed by more traditional means) or if no biologically derived products are currently in widespread use in that indication. Similarly, physicians may not accept a product, such as CIMZIA®, if they believe other products to be more effective or are more comfortable prescribing other products.

Safety concerns may also arise in the course of on-going clinical trials or patient treatment as a result of adverse events or reactions. For example, in February of 2009, the EMEA announced that it had recommended suspension of the marketing authorization of RAPTIVA® in the European Union and EMD Serono Inc., the company that marketed RAPTIVA® in Canada ("EMD Serono") announced that, in consultation with Health Canada, the Canadian health authority ("Health Canada"), it would suspend marketing of RAPTIVA® in Canada. In March of 2009, Merck Serono Australia Pty Ltd, the company that marketed RAPTIVA® in Australia ("Merck Serono Australia"), following a recommendation from the Therapeutic Goods Administration, the Australian health authority ("TGA"), announced that it was withdrawing RAPTIVA® from the Australian market. In the second quarter of 2009, Genentech announced and carried out a phased voluntary withdrawal of RAPTIVA® from the U.S. market, based on the association of RAPTIVA® with an increased risk of PML. As a result, sales of RAPTIVA® ceased in the second quarter of 2009.

Furthermore, government agencies, as well as private organizations involved in healthcare, from time to time publish guidelines or recommendations to healthcare providers and patients. Such guidelines or recommendations can be very influential and may adversely affect the usage of any products we may develop directly (for example, by recommending a decreased dosage of a product in conjunction with a concomitant therapy or a government entity withdrawing its recommendation to screen blood donations for certain viruses) or indirectly (for example, by recommending a competitive product over our product). Consequently, we do not know if physicians or patients will adopt or use our products for their approved indications.

### **We or our third party collaborators or licensees may not have adequate manufacturing capacity sufficient to meet market demand.**

UCB is responsible for manufacturing or arranging for the manufacturing of commercial quantities of CIMZIA®. Should UCB have difficulty in providing manufacturing capacity to produce this product in sufficient

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quantities, we do not know whether they will be able to meet market demand. If not, we will not realize revenue from the sales of this product. If any of our product candidates are approved, because we have never commercially introduced any pharmaceutical products, we do not know whether the capacity of our existing manufacturing facilities can be increased to produce sufficient quantities of our products to meet market demand. Also, if we or our third party collaborators or licensees need additional manufacturing facilities to meet market demand, we cannot predict that we will successfully obtain those facilities because we do not know whether they will be available on acceptable terms. In addition, any manufacturing facilities acquired or used to meet market demand must meet the FDA's quality assurance guidelines.

### **Our agreements with third parties, many of which are significant to our business, expose us to numerous risks.**

Our financial resources and our marketing experience and expertise are limited. Consequently, our ability to successfully develop products depends, to a large extent, upon securing the financial resources and/or marketing capabilities of third parties.

- In April of 1996, we entered into an agreement with Genentech whereby we agreed to co-develop Genentech's humanized monoclonal antibody product RAPTIVA®. In April of 1999, March of 2003, and January of 2005, the companies amended the agreement. In October of 2003, RAPTIVA® was approved by the FDA for the treatment of adults with chronic moderate-to-severe plaque psoriasis who are candidates for systemic therapy or phototherapy and, in September of 2004, Merck Serono announced the product's approval in the European Union. In January of 2005, we entered into a restructuring of our collaboration agreement with Genentech which ended our existing cost and profit sharing arrangement related to RAPTIVA® in the United States and entitled us to a royalty interest on worldwide net sales. In February of 2009, the EMEA announced that it had recommended suspension of the marketing authorization of RAPTIVA® in the European Union and EMD Serono announced that, in consultation with Health Canada, it would suspend marketing of RAPTIVA® in Canada. In March of 2009, Merck Serono Australia, following a recommendation from the TGA, announced that it was withdrawing RAPTIVA® from the Australian market. In the second quarter of 2009, Genentech announced and carried out a phased voluntary withdrawal of RAPTIVA® from the U.S. market, based on the association of RAPTIVA® with an increased risk of PML. As a result, sales of RAPTIVA® ceased in the second quarter of 2009.
- In March of 2004, we announced we had agreed to collaborate with Chiron Corporation (now Novartis) for the development and commercialization of antibody products for the treatment of cancer. In April of 2005, we announced the initiation of clinical testing of the first product candidate out of the collaboration, HCD122, an anti-CD40 antibody, in patients with advanced chronic lymphocytic leukemia. In October of 2005, we announced the initiation of the second clinical trial of HCD122 in patients with multiple myeloma. In November of 2008, we announced the restructuring of this product development collaboration, which involves six development programs including the ongoing HCD122 program. In exchange for cash and debt reduction on our existing loan facility with Novartis, Novartis has control over the HCD122 program and the additional ongoing program, as well as the right to expand the development of these programs into additional indications outside of oncology. We may, in the future, receive milestones of up to \$14 million and double-digit royalty rates for two ongoing product programs, including HCD122. The agreement also provides us with options to develop or receive royalties on four additional programs.
- In March of 2005, we entered into a contract with the National Institute of Allergy and Infectious Diseases ("NIAID") to produce three monoclonal antibodies designed to protect United States citizens against the harmful effects of botulinum neurotoxin used in bioterrorism. In July of 2006, we entered into an additional contract with NIAID for the development of an appropriate formulation for human administration of these three antibodies in a single injection. In September of 2008, we announced that we were awarded an additional contract with NIAID to support our on-going development of drug candidates toward clinical trials in the treatment of botulism poisoning.

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- We have licensed our bacterial cell expression technology, an enabling technology used to discover and screen, as well as develop and manufacture, recombinant antibodies and other proteins for commercial purposes, to over 50 companies. As of December 31, 2009, we were aware of two antibody products manufactured using this technology that have received FDA approval, Genentech's LUCENTIS® (ranibizumab injection) for treatment of neovascular wet age-related macular degeneration and UCB's CIMZIA® (certolizumab pegol) for treatment of Crohn's disease and rheumatoid arthritis.

Because our collaborators and licensees are independent third parties, they may be subject to different risks than we are and have significant discretion in determining the efforts and resources they will apply related to their agreements with us. If these collaborators and licensees do not successfully develop and market these products, we may not have the capabilities, resources or rights to do so on our own. We do not know whether our collaborators or licensees will successfully develop and market any of the products that are or may become the subject of one of our collaboration or licensing arrangements. In particular, each of these arrangements provides for funding solely by our collaborators or licensees. Furthermore, our contracts with NIAID contain numerous standard terms and conditions provided for in the applicable federal acquisition regulations and customary in many government contracts. Uncertainty exists as to whether we will be able to comply with these terms and conditions in a timely manner, if at all. In addition, we are uncertain as to the extent of NIAID's demands and the flexibility that will be granted to us in meeting those demands.

Even when we have a collaborative relationship, other circumstances may prevent it from resulting in successful development of marketable products.

- In September of 2004, we entered into a collaboration arrangement with Aphton Corporation ("Aphton") for the treatment of gastrointestinal and other gastrin-sensitive cancers using anti-gastrin monoclonal antibodies. In January of 2006, Aphton announced that its common stock had been delisted from NASDAQ. In May of 2006, Aphton filed for bankruptcy protection under Chapter 11, Title 11 of the United States Bankruptcy Code.
- In September of 2005, we signed a letter agreement with Cubist Pharmaceuticals, Inc. ("Cubist") to develop production processes and to manufacture a novel two-antibody biologic in quantities sufficient to conduct Phase 3 clinical trials. In July of 2006, Cubist announced that it had decided to cease investment in this product candidate because of stringent FDA requirements for regulatory approval, and as a result we have terminated our letter agreement with Cubist.
- In September of 2006, we entered into an agreement with Taligen Therapeutics, Inc. ("Taligen") which formalized an earlier letter agreement, which was signed in May of 2006, for the development and cGMP manufacture of a novel antibody fragment for the potential treatment of inflammatory diseases. In May of 2007, we and Taligen entered into a letter agreement which provided that we would not produce a cGMP batch at clinical scale pursuant to the terms of the agreement entered into in September of 2006. In addition, the letter agreement provided that we would conduct and complete the technical transfer of the process to Avecia Biologics Limited or its designated affiliate ("Avecia"). The letter agreement also provided that, subject to payment by Taligen of approximately \$1.7 million, we would grant to Avecia a non-exclusive, worldwide, paid-up, non-transferable, non-sublicensable, perpetual license under our owned project innovations. We received \$0.6 million as the first installment under the payment terms of the letter agreement but not the two additional payments totaling approximately \$1.1 million to which we were entitled upon fulfillment of certain obligations. In May of 2009, the matter was resolved by agreement of the parties in a manner that had no further impact on our financial position.

Although we continue to evaluate additional strategic alliances and potential partnerships, we do not know whether or when any such alliances or partnerships will be entered into.

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### **Products and technologies of other companies may render some or all of our products and product candidates noncompetitive or obsolete.**

Developments by others may render our products, product candidates, or technologies obsolete or uncompetitive. Technologies developed and utilized by the biotechnology and pharmaceutical industries are continuously and substantially changing. Competition in the areas of genetically engineered DNA-based and antibody-based technologies is intense and expected to increase in the future as a number of established biotechnology firms and large chemical and pharmaceutical companies advance in these fields. Many of these competitors may be able to develop products and processes competitive with or superior to our own for many reasons, including that they may have:

- significantly greater financial resources,
- larger research and development and marketing staffs,
- larger production facilities,
- entered into arrangements with, or acquired, biotechnology companies to enhance their capabilities, or
- extensive experience in preclinical testing and human clinical trials.

These factors may enable others to develop products and processes competitive with or superior to our own or those of our collaborators. In addition, a significant amount of research in biotechnology is being carried out in universities and other non-profit research organizations. These entities are becoming increasingly interested in the commercial value of their work and may become more aggressive in seeking patent protection and licensing arrangements. Furthermore, many companies and universities tend not to announce or disclose important discoveries or development programs until their patent position is secure or, for other reasons, later; as a result, we may not be able to track development of competitive products, particularly at the early stages. Positive or negative developments in connection with a potentially competing product may have an adverse impact on our ability to raise additional funding on acceptable terms. For example, if another product is perceived to have a competitive advantage, or another product's failure is perceived to increase the likelihood that our product will fail, then investors may choose not to invest in us on terms we would accept or at all.

The examples below pertain to competitive events in the market which we review quarterly and are not intended to be representative of all existing competitive events. Without limiting the foregoing, we are aware that:

#### *XOMA 052*

We have initiated clinical testing of XOMA 052, a potent anti-inflammatory monoclonal antibody targeting IL-1 beta, in Type 2 diabetes patients and cardiovascular disease patients. Other companies are developing other products based on the same or similar therapeutic targets as XOMA 052 and these products may prove more effective than XOMA 052. We are aware that:

- In June of 2009, Novartis announced it had received U.S. marketing approval for Ilaris® (canakinumab), a fully human monoclonal antibody targeting IL-1 beta, to treat children and adults with Cryopyrin-Associated Periodic Syndromes (“CAPS”). In October of 2009, Novartis announced that Ilaris® had been approved in the European Union for CAPS. Canakinumab is also in clinical trials in Type 2 diabetes, chronic obstructive pulmonary disorder, certain forms of gout and systemic juvenile rheumatoid arthritis.
- Eli Lilly and Company (“Lilly”) is developing LY2189102, an investigational IL-1 beta antibody, for bi-weekly subcutaneous injection for the treatment of Type 2 diabetes. Lilly announced the initiation of a Phase 2 study in the third quarter of 2009.
- In 2008, Biovitrum AB obtained a worldwide exclusive license to Amgen Inc. (“Amgen”)’s Kinere® (anakinra) for its current approved indication. Kinere® is an IL-1 receptor antagonist (IL-1ra) currently

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marketed to treat rheumatoid arthritis and has been evaluated over the years in multiple IL-1 mediated diseases, including Type 2 diabetes and other indications we are considering for XOMA 052.

- In February of 2008, Regeneron Pharmaceuticals, Inc. (“Regeneron”) announced it had received marketing approval from the FDA for ARCALYST® (rilonacept) Injection for Subcutaneous Use, an interleukin-1 blocker or IL-1 Trap, for the treatment of CAPS, including Familial Cold Auto-inflammatory Syndrome and Muckle-Wells Syndrome in adults and children 12 and older. In July of 2009, Regeneron announced that rilonacept was recommended for approval in the European Union for CAPS. In March of 2009, Regeneron announced the initiation of a Phase 3 program with rilonacept in gout, which includes four clinical trials.
- Amgen has been developing AMG 108, a fully human monoclonal antibody that targets inhibition of the action of IL-1. On April 28, 2008, Amgen discussed results from its recently completed Phase 2 study in rheumatoid arthritis. AMG 108 showed statistically significant improvement in the signs and symptoms of rheumatoid arthritis and was well tolerated. Amgen announced it is focusing on other opportunities for the antibody.
- In June of 2009, Cytos Biotechnology AG announced the initiation of an ascending dose Phase 1 study of CYT013-IL1bQb, a therapeutic vaccine targeting IL-1 beta, in Type 2 diabetes and that this study is expected to be completed in the first quarter of 2011.

### *XOMA 3AB*

- In May of 2006, the U.S. Department of Health & Human Services awarded Cangene Corporation (“Cangene”) a five-year, \$362 million contract under Project Bioshield. The contract requires Cangene to manufacture and supply 200,000 doses of an equine heptavalent botulism anti-toxin to treat individuals who have been exposed to the toxins that cause botulism. In May of 2008, Cangene announced significant product delivery under this contract.
- Emergent BioSolutions, Inc. is currently in development of a botulism immunoglobulin candidate that may compete with our anti-botulinum neurotoxin monoclonal antibodies.
- We are aware of additional companies that are pursuing biodefense-related antibody products. PharmAthene, Inc. and Human Genome Sciences, Inc. are developing anti-anthrax antibodies. Cangene and Emergent BioSolutions, Inc. are developing anti-anthrax immune globulin products. These products may compete with our efforts in the areas of other monoclonal antibody-based biodefense products, and the manufacture of antibodies to supply strategic national stockpiles.

### *CIMZIA®*

In addition to CIMZIA®, there are four other FDA-approved anti-TNF therapies to treat moderate-to-severe rheumatoid arthritis: Amgen’s Enbrel® (etanercept), Johnson & Johnson’s Remicade® (infliximab) and Simponi™ (golimumab) and Abbott Laboratories’ Humira® (adalimumab), with two of them, infliximab and adalimumab, also approved for moderate-to-severe active Crohn’s disease in adults.

### **Manufacturing risks and inefficiencies may adversely affect our ability to manufacture products for ourselves or others.**

To the extent we continue to provide manufacturing services for our own benefit or to third parties, we are subject to manufacturing risks. Additionally, unanticipated fluctuations in customer requirements have led and may continue to lead to manufacturing inefficiencies. We must utilize our manufacturing operations in compliance with regulatory requirements, in sufficient quantities and on a timely basis, while maintaining acceptable product quality and manufacturing costs. Additional resources and changes in our manufacturing processes may be required for each new product, product modification or customer or to meet changing regulatory or third party requirements, and this work may not be successfully or efficiently completed. In

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addition, to the extent we continue to provide manufacturing services, our fixed costs, such as facility costs, would be expected to increase, as would necessary capital investment in equipment and facilities.

Manufacturing and quality problems may arise in the future to the extent we continue to perform these services for our own benefit or for third parties. Consequently, our development goals or milestones may not be achieved in a timely manner or at a commercially reasonable cost, or at all. In addition, to the extent we continue to make investments to improve our manufacturing operations, our efforts may not yield the improvements that we expect.

**Because many of the companies we do business with are also in the biotechnology sector, the volatility of that sector can affect us indirectly as well as directly.**

As a biotechnology company that collaborates with other biotech companies, the same factors that affect us directly can also adversely impact us indirectly by affecting the ability of our collaborators, partners and others we do business with to meet their obligations to us and reduce our ability to realize the value of the consideration provided to us by these other companies.

For example, in connection with our licensing transactions relating to our bacterial cell expression technology, we have in the past and may in the future agree to accept equity securities of the licensee in payment of license fees. The future value of these or any other shares we receive is subject both to market risks affecting our ability to realize the value of these shares and more generally to the business and other risks to which the issuer of these shares may be subject.

**As we do more business internationally, we will be subject to additional political, economic and regulatory uncertainties.**

We may not be able to successfully operate in any foreign market. We believe that, because the pharmaceutical industry is global in nature, international activities will be a significant part of our future business activities and that, when and if we are able to generate income, a substantial portion of that income will be derived from product sales and other activities outside the United States. Foreign regulatory agencies often establish standards different from those in the United States, and an inability to obtain foreign regulatory approvals on a timely basis could put us at a competitive disadvantage or make it uneconomical to proceed with a product or product candidate's development. International operations and sales may be limited or disrupted by:

- imposition of government controls,
- export license requirements,
- political or economic instability,
- trade restrictions,
- changes in tariffs,
- restrictions on repatriating profits,
- exchange rate fluctuations,
- withholding and other taxation, and
- difficulties in staffing and managing international operations.

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### **If we and our partners are unable to protect our intellectual property, in particular our patent protection for our principal products, product candidates and processes, and prevent its use by third parties, our ability to compete in the market will be harmed, and we may not realize our profit potential.**

We rely on patent protection, as well as a combination of copyright, trade secret, and trademark laws to protect our proprietary technology and prevent others from duplicating our products or product candidates. However, these means may afford only limited protection and may not:

- prevent our competitors from duplicating our products;
- prevent our competitors from gaining access to our proprietary information and technology, or
- permit us to gain or maintain a competitive advantage.

Because of the length of time and the expense associated with bringing new products to the marketplace, we and our partners hold and are in the process of applying for a number of patents in the United States and abroad to protect our product candidates and important processes and also have obtained or have the right to obtain exclusive licenses to certain patents and applications filed by others. However, the mere issuance of a patent is not conclusive as to its validity or its enforceability. The United States Federal Courts or equivalent national courts or patent offices elsewhere may invalidate our patents or find them unenforceable. In addition, the laws of foreign countries may not protect our intellectual property rights effectively or to the same extent as the laws of the United States. If our intellectual property rights are not adequately protected, we may not be able to commercialize our technologies, products, or services, and our competitors could commercialize our technologies, which could result in a decrease in our sales and market share that would harm our business and operating results. Specifically, the patent position of biotechnology companies generally is highly uncertain and involves complex legal and factual questions. The legal standards governing the validity of biotechnology patents are in transition, and current defenses as to issued biotechnology patents may not be adequate in the future. Accordingly, there is uncertainty as to:

- whether any pending or future patent applications held by us will result in an issued patent, or that if patents are issued to us, that such patents will provide meaningful protection against competitors or competitive technologies,
- whether competitors will be able to design around our patents or develop and obtain patent protection for technologies, designs or methods that are more effective than those covered by our patents and patent applications, or
- the extent to which our product candidates could infringe on the intellectual property rights of others, which may lead to costly litigation, result in the payment of substantial damages or royalties, and/or prevent us from using technology that is essential to our business.

We have established an extensive portfolio of patents and applications, both United States and foreign, related to our BPI-related product candidates, including novel compositions, their manufacture, formulation, assay and use. We have also established a portfolio of patents, both United States and foreign, related to our bacterial cell expression technology, including claims to novel promoter sequences, secretion signal sequences, compositions and methods for expression and secretion of recombinant proteins from bacteria, including immunoglobulin gene products. Most of the more important European patents in our bacterial cell expression patent portfolio expired in July of 2008.

If certain patents issued to others are upheld or if certain patent applications filed by others issue and are upheld, we may require licenses from others in order to develop and commercialize certain potential products incorporating our technology or we may become involved in litigation to determine the proprietary rights of others. These licenses, if required, may not be available on acceptable terms, and any such litigation may be costly and may have other adverse effects on our business, such as inhibiting our ability to compete in the marketplace and absorbing significant management time.

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Due to the uncertainties regarding biotechnology patents, we also have relied and will continue to rely upon trade secrets, know-how and continuing technological advancement to develop and maintain our competitive position. All of our employees have signed confidentiality agreements under which they have agreed not to use or disclose any of our proprietary information. Research and development contracts and relationships between us and our scientific consultants and potential customers provide access to aspects of our know-how that are protected generally under confidentiality agreements. These confidentiality agreements may be breached or may not be enforced by a court. To the extent proprietary information is divulged to competitors or to the public generally, such disclosure may adversely affect our ability to develop or commercialize our products by giving others a competitive advantage or by undermining our patent position.

### **Litigation regarding intellectual property can be costly and expose us to risks of counterclaims against us.**

We may be required to engage in litigation or other proceedings to protect our intellectual property. The cost to us of this litigation, even if resolved in our favor, could be substantial. Such litigation could also divert management's attention and resources. In addition, if this litigation is resolved against us, our patents may be declared invalid, and we could be held liable for significant damages. In addition, we may be subject to a claim that we are infringing another party's patent. If such claim is resolved against us, we or our collaborators may be enjoined from developing, manufacturing, selling or importing products, processes or services unless we obtain a license from the other party. Such license may not be available on reasonable terms, thus preventing us from using these products, processes or services and adversely affecting our revenue.

### **Even if we or our third party collaborators or licensees bring products to market, we may be unable to effectively price our products or obtain adequate reimbursement for sales of our products, which would prevent our products from becoming profitable.**

If we or our third party collaborators or licensees succeed in bringing our product candidates to the market, they may not be considered cost-effective, and reimbursement to the patient may not be available or may not be sufficient to allow us to sell our products on a competitive basis. In both the United States and elsewhere, sales of medical products and treatments are dependent, in part, on the availability of reimbursement to the patient from third-party payors, such as government and private insurance plans. Third-party payors are increasingly challenging the prices charged for pharmaceutical products and services. Our business is affected by the efforts of government and third-party payors to contain or reduce the cost of healthcare through various means. In the United States, there have been and will continue to be a number of federal and state proposals to implement government controls on pricing. In addition, the emphasis on managed care in the United States has increased and will continue to increase the pressure on the pricing of pharmaceutical products. We cannot predict whether any legislative or regulatory proposals will be adopted or the effect these proposals or managed care efforts may have on our business.

### **Healthcare reform measures and other statutory or regulatory changes could adversely affect our business.**

The pharmaceutical and biotechnology industries are subject to extensive regulation, and from time to time legislative bodies and governmental agencies consider changes to such regulations that could have significant impact on industry participants. For example, in light of certain highly-publicized safety issues regarding certain drugs that had received marketing approval, the U.S. Congress is considering various proposals regarding drug safety, including some which would require additional safety studies and monitoring and could make drug development more costly. We are unable to predict what additional legislation or regulation, if any, relating to safety or other aspects of drug development may be enacted in the future or what effect such legislation or regulation would have on our business.

The business and financial condition of pharmaceutical and biotechnology companies are also affected by the efforts of governments, third-party payors and others to contain or reduce the costs of healthcare to consumers. In the United States and various foreign jurisdictions there have been, and we expect that there will

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continue to be, a number of legislative and regulatory proposals aimed at changing the healthcare system, such as proposals relating to the reimportation of drugs into the U.S. from other countries (where they are then sold at a lower price) and government control of prescription drug pricing. The pendency or approval of such proposals could result in a decrease in our share price or limit our ability to raise capital or to obtain strategic collaborations or licenses.

### **We are exposed to an increased risk of product liability claims, and a series of related cases is currently pending against us.**

The testing, marketing and sales of medical products entails an inherent risk of allegations of product liability. In the event of one or more large, unforeseen awards of damages against us, our product liability insurance may not provide adequate coverage. A significant product liability claim for which we were not covered by insurance would have to be paid from cash or other assets. To the extent we have sufficient insurance coverage, such a claim would result in higher subsequent insurance rates. In addition, product liability claims can have various other ramifications including loss of future sales opportunities, increased costs associated with replacing products, and a negative impact on our goodwill and reputation, which could also adversely affect our business and operating results.

On April 9, 2009, a complaint was filed in the Superior Court of Alameda County, California, in a lawsuit captioned *Hedrick et al. v. Genentech, Inc. et al*, Case No. 09-446158. The complaint asserts claims against Genentech, us and others for alleged strict liability for failure to warn, strict product liability, negligence, breach of warranty, fraudulent concealment, wrongful death and other claims based on injuries alleged to have occurred as a result of three individuals' treatment with RAPTIVA®. The complaint seeks unspecified compensatory and punitive damages. Since then, additional complaints have been filed in the same court, bringing the total number of pending cases to twenty-one. All of the complaints allege the same claims and seek the same types of damages based on injuries alleged to have occurred as a result of the plaintiffs' treatment with RAPTIVA®. Even though Genentech has agreed to indemnify us, there can be no assurance that this or other products liability lawsuits will not result in liability to us or that our insurance or contractual arrangements will provide us with adequate protection against such liabilities.

### **The loss of key personnel, including our Chief Executive Officer, could delay or prevent achieving our objectives.**

Our research, product development and business efforts could be adversely affected by the loss of one or more key members of our scientific or management staff, particularly our executive officers: Steven B. Engle, our Chairman, Chief Executive Officer and President; Fred Kurland, our Vice President, Finance and Chief Financial Officer; Patrick J. Scannon, M.D., Ph.D., our Executive Vice President and Chief Medical Officer; and Christopher J. Margolin, our Vice President, General Counsel and Secretary. We currently have no key person insurance on any of our employees.

### **We may not realize the expected benefits of our initiatives to reduce costs across our operations, and we may incur significant charges or write-downs as part of these efforts.**

We have pursued and may continue to pursue a number of initiatives to reduce costs across our operations. In January of 2009, we implemented a workforce reduction of approximately 42% in order to improve our cost structure. As a result, we achieved an annualized reduction in cash expenditures of approximately \$27 million. We recorded charges in 2009 of \$3.1 million for severance, other employee benefits and outplacement services related to the workforce reduction. In the second quarter of 2009, we vacated one of our leased buildings and recorded a restructuring charge of \$0.5 million primarily related to the net present value of the net future minimum lease payments, less the estimated future sublease income.

In addition, one building remains temporarily vacant, in order to optimize our facility usage. As manufacturing demand increases in the future, we plan to resume operations at this facility. The net book value

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of fixed assets in the vacant building potentially subject to write-down is approximately \$4.2 million as of December 31, 2009. Although we have determined that there was no impairment of the assets as of December 31, 2009, there can be no assurance that we will not determine otherwise as of a future date and as a consequence write down these assets as impaired.

We may not realize some or all of the expected benefits of our current and future initiatives to reduce costs. In addition to restructuring or other charges, we may experience disruptions in our operations as a result of these initiatives and write-downs.

### **U.S. holders of our common shares and warrants could be subject to material adverse U.S. federal income tax consequences if we were considered to be a PFIC currently or in the future.**

A non-U.S. corporation generally will be a “passive foreign investment company,” or PFIC, for U.S. federal income tax purposes in any taxable year in which, after applying the relevant look-through rules with respect to the income and assets of its subsidiaries, either 75% or more of its gross income is “passive income” (generally including (without limitation) dividends, interest, annuities and certain royalties and rents not derived in the active conduct of a business) or the average value of its assets that produce passive income or are held for the production of passive income is at least 50% of the total value of its assets. In determining whether we meet the 50% test, cash is considered a passive asset and the total value of our assets generally will be treated as equal to the sum of the aggregate fair market value of our outstanding common shares plus our liabilities. If we own at least 25% (by value) of the stock of another corporation, we will be treated, for purposes of the PFIC tests, as owning our proportionate share of the other corporation’s assets and receiving our proportionate share of the other corporation’s income.

We believe that we were not a PFIC for the 2009 taxable year. However, because PFIC status is determined annually and depends on the composition of a company’s income and assets and the fair market value of its assets (including goodwill), which may be volatile in our industry, there can be no assurance that we will not be considered a PFIC for 2010 or any subsequent year. For example, taking into account our existing cash balances, if the value of our common shares were to decline materially, it is possible that we could become a PFIC in 2010 or a subsequent year. Additionally, due to the complexity of the PFIC provisions and the limited authority available to interpret such provisions, there can be no assurance that our determination regarding our PFIC status could not be successfully challenged by the Internal Revenue Service (“IRS”).

If we were found to be a PFIC for any taxable year in which a U.S. holder (as defined below) held common shares or warrants, certain adverse U.S. federal income tax consequences could apply to such U.S. holder, including a recharacterization of any capital gain recognized on a sale or other disposition of common shares or warrants as ordinary income, ineligibility for any preferential tax rate otherwise applicable to any “qualified dividend income,” a material increase in the amount of tax that such U.S. holder would owe and the possible imposition of interest charges, an imposition of tax earlier than would otherwise be imposed and additional tax form filing requirements.

For purposes of this discussion, the term “U.S. holder” means a beneficial owner of common shares or warrants that is, for U.S. federal income tax purposes, (i) an individual who is a U.S. citizen or resident, (ii) a corporation (or other entity treated as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States, any state thereof or the District of Columbia, (iii) an estate the income of which is includable in gross income for U.S. income tax purposes regardless of its source, or (iv) a trust, if a U.S. court is able to exercise primary supervision over the administration of the trust and one or more U.S. fiduciaries have the authority to control all substantial decisions of the trust, or if the trust has a valid election in effect under applicable U.S. Treasury Regulations to be treated as a U.S. person.

A U.S. holder owning shares in a PFIC (or a corporation that might become a PFIC) might be able to mitigate the adverse tax consequences of PFIC status by making certain elections, including “qualified electing

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fund” (a “QEF”) or “mark-to-market” elections, if deemed appropriate based on guidance provided by its tax advisor. However, it should be noted that (1) the beneficial effect of a QEF election or a mark-to-market election may be substantially diminished if such election is not made from the inception of a U.S. holder’s holding period (a “Year One Election”), (2) neither a QEF election nor a mark-to-market election can be made with respect to the warrants, (3) a Year One Election generally cannot be made for any common shares received upon exercise of the warrants (“Warrant Shares”) because the holding period of Warrant Shares is deemed, for QEF election and mark-to-market election purposes, to include the holding period of the underlying warrants but the QEF election or a mark-to-market election will not be effective until the taxable year in which the underlying warrants are exercised, and (4) a QEF election or a mark-to-market election is made on a shareholder-by-shareholder basis and, once made, can only be revoked with the consent of the IRS.

The PFIC rules are very complex, as are the requirements and effects of the various elections designed to mitigate the adverse consequences of the PFIC rules. A prospective U.S. holder should consult its own tax advisor regarding the PFIC rules, including the foregoing limitations on the ability to make a QEF election or a mark-to-market election (or to qualify either such election as a Year One Election), the timing requirements with respect to the various elections and the irrevocability of certain elections (absent the consent of the IRS).

A U.S. Holder may be required to file IRS Form 8621 if the U.S. Holder holds our common shares in any taxable year in which we are classified as a PFIC (whether or not a QEF or mark-to-market election is made).

### **Our ability to use our net operating loss carry-forwards and other tax attributes will be substantially limited by Section 382 of the Internal Revenue Code.**

Section 382 of the Internal Revenue Code of 1986, as amended, generally limits the ability of a corporation that undergoes an “ownership change” to utilize its net operating loss carry-forwards (“NOLs”) and certain other tax attributes against any taxable income in taxable periods after the ownership change. The amount of taxable income in each taxable year after the ownership change that may be offset by pre-change NOLs and certain other pre-change tax attributes is generally equal to the product of (a) the fair market value of the corporation’s outstanding shares immediately prior to the ownership change and (b) the long-term tax exempt rate (i.e., a rate of interest established by the IRS that fluctuates from month to month). In general, an “ownership change” occurs whenever the percentage of the shares of a corporation owned, directly or indirectly, by “5-percent shareholders” (within the meaning of Section 382 of the Internal Revenue Code) increases by more than 50 percentage points over the lowest percentage of the share of such corporation owned, directly or indirectly, by such “5-percent shareholders” at any time over the preceding three years.

In 2009, we experienced an ownership change under Section 382, which subjects the amount of NOLs and other tax credit carry-forwards that can be utilized to an annual limitation, which will substantially limit the future use of our pre-change NOLs and certain other pre-change tax attributes per year.

### **Because we are a relatively small biopharmaceutical company with limited resources, we may not be able to attract and retain qualified personnel.**

Our success in developing marketable products and achieving a competitive position will depend, in part, on our ability to attract and retain qualified scientific and management personnel, particularly in areas requiring specific technical, scientific or medical expertise. We had approximately 195 employees as of March 9, 2010. We anticipate that we will require additional experienced executive, accounting, research and development, legal, administrative and other personnel in the future. There is intense competition for the services of these personnel, especially in California. Moreover, we expect that the high cost of living in the San Francisco Bay Area, where our headquarters and manufacturing facilities are located, may impair our ability to attract and retain employees in the future. If we do not succeed in attracting new personnel and retaining and motivating existing personnel, our operations may suffer and we may be unable to implement our current initiatives or grow effectively.

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### **Calamities, power shortages or power interruptions at our Berkeley headquarters and manufacturing facility could disrupt our business and adversely affect our operations, and could disrupt the businesses of our customers.**

Our principal operations are located in Northern California, including our corporate headquarters and manufacturing facility in Berkeley, California. In addition, many of our collaborators and licensees are located in California. All of these locations are in areas of seismic activity near active earthquake faults. Any earthquake, terrorist attack, fire, power shortage or other calamity affecting our facilities or our customers' facilities may disrupt our business and could have material adverse effect on our business and results of operations.

### **We may be subject to increased risks because we are a Bermuda company.**

Alleged abuses by certain companies that have changed their legal domicile from jurisdictions within the United States to Bermuda have created an environment where, notwithstanding that we changed our legal domicile in a transaction that was approved by our shareholders and fully taxable to our company under United States law, we may be exposed to various prejudicial actions, including:

- “blacklisting” of our common shares by certain pension funds,
- legislation restricting certain types of transactions, and
- punitive tax legislation.

We do not know whether any of these things will happen, but if implemented one or more of them may have an adverse impact on our future operations or our share price.

### **It may be difficult to enforce a judgment obtained against us because we are a foreign entity.**

We are a Bermuda company. All or a substantial portion of our assets, including substantially all of our intellectual property, may be located outside the United States. As a result, it may be difficult for shareholders and others to enforce in United States courts judgments obtained against us. We have irrevocably agreed that we may be served with process with respect to actions based on offers and sales of securities made hereby in the United States by serving Christopher J. Margolin, c/o XOMA Ltd., 2910 Seventh Street, Berkeley, California 94710, our United States agent appointed for that purpose. Uncertainty exists as to whether Bermuda courts would enforce judgments of United States courts obtained in actions against us or our directors and officers that are predicated upon the civil liability provisions of the United States securities laws or entertain original actions brought in Bermuda against us or such persons predicated upon the United States securities laws. There is no treaty in effect between the United States and Bermuda providing for such enforcement, and there are grounds upon which Bermuda courts may not enforce judgments of United States courts. Certain remedies available under the United States federal securities laws may not be allowed in Bermuda courts as contrary to that nation's policy.

### **Our shareholder rights agreement or bye-laws may prevent transactions that could be beneficial to our shareholders and may insulate our management from removal.**

In February of 2003, we adopted a new shareholder rights agreement (to replace the shareholder rights agreement that had expired), which could make it considerably more difficult or costly for a person or group to acquire control of us in a transaction that our Board of Directors opposes.

Our bye-laws:

- require certain procedures to be followed and time periods to be met for any shareholder to propose matters to be considered at annual meetings of shareholders, including nominating directors for election at those meetings;

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- authorize our Board of Directors to issue up to 1,000,000 preference shares without shareholder approval and to set the rights, preferences and other designations, including voting rights, of those shares as the Board of Directors may determine; and
- contain provisions, similar to those contained in the Delaware General Corporation Law that may make business combinations with interested shareholders more difficult.

These provisions of our shareholders rights agreement and our bye-laws, alone or in combination with each other, may discourage transactions involving actual or potential changes of control, including transactions that otherwise could involve payment of a premium over prevailing market prices to holders of common shares, could limit the ability of shareholders to approve transactions that they may deem to be in their best interests, and could make it considerably more difficult for a potential acquirer to replace management.

### **Item 1B. Unresolved Staff Comments**

None.

### **Item 2. Properties**

Our corporate headquarters and development and manufacturing facilities are located in Berkeley and Emeryville, California. We currently lease five buildings, and space in a sixth building, for which we are actively seeking a sublease tenant. These buildings house our research and development laboratories, manufacturing facilities and office space. A separate pilot scale manufacturing facility is owned by us. Our building leases expire in the period from 2011 to 2014 and total minimum lease payments due from January of 2010 until expiration of the leases are \$19.2 million. We have the option to renew our lease agreements for periods ranging from three to ten years.

On January 15, 2009, we announced a workforce reduction of approximately 42 percent or 144 employees, a majority of which were employed in manufacturing and related support functions. This decision was based on a decrease in forecasted contract manufacturing demand in 2009. As a result, in the second quarter of 2009, we vacated one of our leased buildings resulting in a restructuring charge. In addition, our pilot scale manufacturing facility is temporarily vacant, in order to optimize our facility usage. As manufacturing demand increases in the future, we plan to resume operations at this facility. The net book value of fixed assets in our pilot scale manufacturing facility potentially subject to write-down is approximately \$4.2 million as of December 31, 2009.

Due to the decrease in contract manufacturing demand in 2009, our primary leased manufacturing facilities were idle for the majority of 2009. At our pilot scale manufacturing facility, we performed small scale process development of several antibodies in development, pursuant to a drug manufacturing license obtained from the State of California.

In the fourth quarter of 2009, we resumed operations in our primary leased manufacturing facilities. In 2010, we plan to produce multiple anti-botulinum neurotoxin antibodies in support of our contracts with the National Institute of Allergy and Infectious Diseases (“NIAID”), a part of the National Institutes of Health (“NIH”), at these facilities. Subject to future manufacturing demand, we believe that our facilities are suitable and adequate for our current level of operations and anticipated growth in the near future.

### **Item 3. Legal Proceedings**

On April 9, 2009, a complaint was filed in the Superior Court of Alameda County, California, in a lawsuit captioned *Hedrick et al. v. Genentech, Inc. et al*, Case No. 09-446158. The complaint asserts claims against Genentech, XOMA Ltd. (the “Company”) and others for alleged strict liability for failure to warn, strict product liability, negligence, breach of warranty, fraudulent concealment, wrongful death and other claims based on injuries alleged to have occurred as a result of three individuals’ treatment with RAPTIVA®. The complaint

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seeks unspecified compensatory and punitive damages. Since then, additional complaints have been filed in the same court, bringing the total number of pending cases to twenty-one. All of the complaints allege the same claims and seek the same types of damages based on injuries alleged to have occurred as a result of the plaintiffs' treatment with RAPTIVA®. The Company's agreement with Genentech provides for an indemnity of XOMA and payment of legal fees by Genentech which the Company believes is applicable to this matter. The Company believes the claims against it to be without merit and intends to defend against them vigorously.

In September of 2004, XOMA (US) LLC entered into a collaboration with Aphton for the treatment of gastrointestinal and other gastrin-sensitive cancers using anti-gastrin monoclonal antibodies. In May of 2006, Aphton filed for bankruptcy protection under Chapter 11, Title 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware, No. 06-10510 (CSS). XOMA (US) LLC filed a proof of claim in the proceeding, as an unsecured creditor of Aphton, for approximately \$594,000. Aphton and the Official Committee of Unsecured Creditors filed a Proposed Plan of Reorganization ("the Plan") that would result in a liquidation of Aphton. The creditors have voted in favor of the plan, and the bankruptcy court has confirmed it. A litigation trustee appointed under the Plan is currently pursuing litigation against various parties other than the Company, and any recovery by the Company under the Plan will depend on the outcome of such litigation. It is not presently known what, if any, distributions will be made to holders of unsecured claims. There were no developments material to XOMA in the proceedings involving Aphton during the year ended December 31, 2009.

### **Item 4. Reserved**

#### **Supplementary Item: Executive Officers of the Registrant**

Our executive officers and their respective ages, as of December 31, 2009, and positions are as follows:

<u>Name</u>	<u>Age</u>	<u>Title</u>
Steven B. Engle	55	Chairman, Chief Executive Officer and President
Patrick J. Scannon, M.D., Ph.D.	62	Executive Vice President and Chief Medical Officer
Fred Kurland	59	Vice President, Finance and Chief Financial Officer
Christopher J. Margolin, Esq.	63	Vice President, General Counsel and Secretary

The Board of Directors elects all officers annually. There is no family relationship between or among any of the officers or directors.

#### **Business Experience**

**Mr. Engle** is XOMA's Chairman, Chief Executive Officer and President. He has more than 25 years of executive leadership and biotechnology and pharmaceutical industry experience and, in February of 2010, was elected to the board of directors of the Biotechnology Industry Organization, or BIO. Prior to joining XOMA in 2007, he served as Chairman of the Board and Chief Executive Officer of La Jolla Pharmaceutical Company, a publicly-held biopharmaceutical company focused on the research and development of therapeutic products for autoimmune and antibody-mediated diseases. He joined La Jolla Pharmaceutical Company in 1993, became President and a Director in 1994, Chief Executive Officer in 1995, and Chairman of the Board in 1997. Prior to joining La Jolla, he held executive-level positions at Cygnus Therapeutic Systems, a developer of drug delivery systems, and Micro Power Systems, Inc., a manufacturer of high technology products, including medical devices. He began his professional career with the Strategic Decisions Group and the Stanford Research Institute. Mr. Engle holds an M.S.E.E. and a B.S.E.E. with a focus in biomedical engineering from the University of Texas.

**Dr. Scannon** is one of our founders and has served as a Director since our formation. Dr. Scannon became Executive Vice President and Chief Medical Officer in May of 2009. Previously he was our Executive Vice

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President and Chief Biotechnology Officer beginning in May of 2006 and served as Chief Scientific and Medical Officer from March of 1993 until May of 2006, Vice Chairman, Scientific and Medical Affairs from April of 1992 to March of 1993 and our President from our formation until April of 1992. In 2007, Dr. Scannon was invited to join the newly formed National Biodefense Science Board, reporting to the Secretary for the Department of Health and Human Services. In 2007, he also became a member of the Board of Directors for Pain Therapeutics, Inc, a biopharmaceutical company. He serves on the Defense Sciences Research Council for the Defense Advanced Research Projects Agency (DARPA) and on the Threat Reduction Advisory Committee for the Department of Defense. From 1979 until 1981, Dr. Scannon was a clinical research scientist at the Letterman Army Institute of Research in San Francisco. A Board-certified internist, Dr. Scannon holds a Ph.D. in organic chemistry from the University of California, Berkeley and an M.D. from the Medical College of Georgia.

**Mr. Kurland** is our Vice President, Finance and Chief Financial Officer. He joined XOMA on December 29, 2008. Mr. Kurland is responsible for directing the Company's financial strategy, accounting, financial planning and investor relations functions. He has more than 30 years of experience in biotechnology and pharmaceutical companies including Aviron/MedImmune, Protein Design Labs and Syntex/Roche. Prior to joining XOMA, Mr. Kurland served as Chief Financial Officer of Bayhill Therapeutics, Inc., Corcept Therapeutics Incorporated and Genitope Corporation. From 1998 to 2002, Mr. Kurland served as Senior Vice President and Chief Financial Officer of Aviron, acquired by MedImmune in 2001 and developer of FluMist. From 1996 to 1998, he was Vice President and Chief Financial Officer of Protein Design Labs, Inc., an antibody design company, and from 1995 to 1996, he served as Vice President and Chief Financial Officer of Applied Immune Sciences, Inc. Mr. Kurland also held a number of financial management positions at Syntex Corporation, a pharmaceutical company acquired by Roche, including Vice President and Controller between 1991 and 1995. He received his J.D. and M.B.A. degrees from the University of Chicago and his B.S. degree from Lehigh University.

**Mr. Margolin** is our Vice President, General Counsel and Secretary. During his time with the Company, Mr. Margolin has been responsible for the legal and intellectual property function and, at various times, the business development, human resources and licensing functions. Prior to joining us in 1991, Mr. Margolin was a corporate attorney holding several different executive legal positions for Raychem Corporation, an international high technology company, for 11 years. From 1975 to 1980, he was a division counsel for TRW Inc. and from 1972 to 1975, he was an associate at the law firm of McCutchen, Black, Verleger and Shea in Los Angeles. Mr. Margolin holds a B.A. from Princeton University, a J.D. from the University of Pennsylvania and an M.B.A. from the University of California, Los Angeles.

**PART II**

**Item 5. Market for Registrant’s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities**

**Market for Registrant’s Common Equity**

Our common shares trade on The NASDAQ Global Market under the symbol “XOMA.” The following table sets forth the quarterly range of high and low reported sale prices of our common shares on The NASDAQ Global Market for the periods indicated:

	Price Range	
	High	Low
<b>2009</b>		
First Quarter	\$ 0.94	\$ 0.37
Second Quarter	1.34	0.40
Third Quarter	1.08	0.71
Fourth Quarter	0.84	0.63
<b>2008</b>		
First Quarter	\$ 3.37	\$ 2.21
Second Quarter	2.78	1.68
Third Quarter	2.40	1.58
Fourth Quarter	2.09	0.59

On March 9, 2010, there were 2,593 shareholders of record of our common shares, one of which was Cede & Co., a nominee for Depository Trust Company (“DTC”). All of the common shares held by brokerage firms, banks and other financial institutions as nominees for beneficial owners are deposited into participant accounts at DTC and are therefore considered to be held of record by Cede & Co. as one shareholder.

**Dividend Policy**

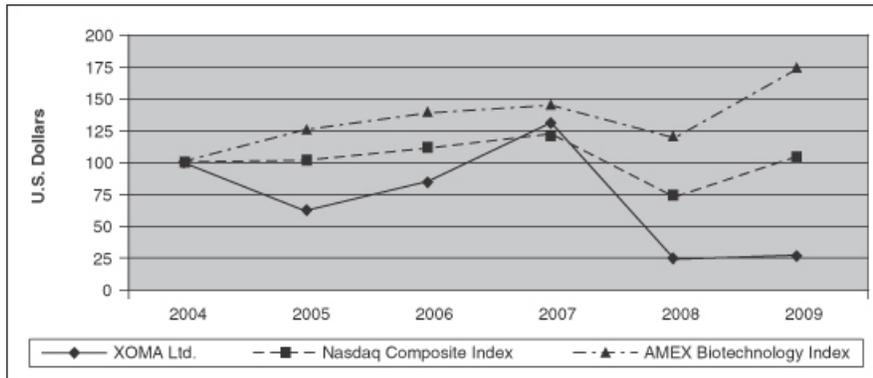
We have not paid dividends on our common shares. We currently intend to retain any earnings for use in the development and expansion of our business. We, therefore, do not anticipate paying cash dividends on our common shares in the foreseeable future.

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**Performance Graph**

The following graph compares the five-year cumulative total shareholder return for XOMA common stock with the comparable cumulative return of certain indices. The graph assumes \$100 invested on the same date in each of the indices. Returns of the company are not indicative of future performance.

**FIVE-YEAR PERFORMANCE GRAPH**



As of December 31,	XOMA Ltd.	Nasdaq Composite Index	AMEX Biotechnology Index
2004	\$ 100.00	\$ 100.00	\$ 100.00
2005	61.78	101.37	125.11
2006	84.94	111.03	138.59
2007	130.89	121.92	144.51
2008	23.94	72.49	118.91
2009	27.03	104.31	173.11

**Debt and Equity Issuances**

*ATM Agreement*

In the third quarter of 2009, we entered into an At Market Issuance Sales Agreement (the “ATM Agreement”), with Wm Smith & Co. (“Wm Smith”), under which we may sell up to 25 million of our common shares from time to time through Wm Smith, as the agent for the offer and sale of the common shares. Wm Smith may sell these common shares by any method permitted by law deemed to be an “at the market” offering as defined in Rule 415 of the Securities Act of 1933, including but not limited to sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. Wm Smith may also sell the common shares in privately negotiated transactions, subject to our approval. We pay Wm Smith a commission equal to 3% of the gross proceeds of all common shares sold through it as sales agent under the ATM Agreement but in no event less than \$0.02 per share. Shares sold under the ATM Agreement are sold pursuant to a prospectus which forms a part of a registration statement declared effective by the Securities and Exchange Commission on May 29, 2008. From the inception of the ATM Agreement through December 31, 2009, we sold a total of 4,050,617 common shares through Wm Smith for aggregate gross proceeds of \$2.9 million. Total offering expenses related to these sales were \$0.1 million. Refer to *Item 7: Management’s Discussion and Analysis of Financial Condition and Results of Operations: Subsequent Events* for disclosure regarding the number of common shares sold under this agreement subsequent to the end of 2009.

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### ***Registered Direct Offerings***

In May of 2009, we entered into a definitive agreement with an institutional investor to sell 11,764,706 units, with each unit consisting of one of our common shares and a warrant to purchase 0.50 of a common share, for gross proceeds of approximately \$10 million, before deducting placement agent fees and estimated offering expenses of \$0.8 million, in a registered direct offering. The investor purchased the units at a price of \$0.85 per unit. The warrants, which represent the right to acquire an aggregate of up to 5,882,353 common shares, were exercisable at any time on or after May 15, 2009 and prior to May 20, 2014 at an exercise price of \$1.02 per share. As of December 31, 2009, all warrants issued in May of 2009 remained outstanding. Refer to *Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations: Subsequent Events* for disclosure regarding certain amendments made to the terms of the warrants issued in May of 2009 and the number of shares issued upon exercise of these warrants subsequent to the end of 2009.

In June of 2009, we entered into a definitive agreement with certain institutional investors to sell 10,434,782 units, with each unit consisting of one of our common shares and a warrant to purchase 0.50 of a common share, for gross proceeds of approximately \$12 million, before deducting placement agent fees and estimated offering expenses of \$0.8 million, in a second registered direct offering. The investor purchased the units at a price of \$1.15 per unit. The warrants, which represent the right to acquire an aggregate of up to 5,217,391 common shares, are exercisable at any time on or prior to December 10, 2014 at an exercise price of \$1.30 per share. As of December 31, 2009, all warrants issued in June of 2009 remained outstanding. Refer to *Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations: Subsequent Events* for disclosure regarding certain amendments made to the terms of the warrants issued in June of 2009 subsequent to the end of 2009.

### ***Equity Line of Credit***

On October 21, 2008, we entered into a common share purchase agreement (the "Purchase Agreement") with Azimuth Opportunity Ltd. ("Azimuth"), pursuant to which we obtained a committed equity line of credit facility (the "Facility") under which we could sell up to \$60 million of our registered common shares to Azimuth over a 24-month period, subject to certain conditions and limitations. The Purchase Agreement required a minimum share price of \$1.00 per share to allow us to issue shares to Azimuth under the Facility. However, at its election, Azimuth could buy shares below the threshold price at a negotiated discount. We were not obligated to utilize any of the \$60 million Facility and remained free to enter other financing transactions. Shares under the Facility were sold pursuant to a prospectus which forms a part of a registration statement declared effective by the Securities and Exchange Commission on May 29, 2008. At the end of the third quarter of 2009, the Facility was no longer in effect, and no additional shares could be issued thereunder.

From the inception of the Facility in October of 2008 through 2009, we sold a total of 42,228,428 common shares to Azimuth for aggregate gross proceeds of \$33.9 million. This included the sale of 4.0 million shares under the Facility in December of 2008 and 34.3 million shares in two transactions in September of 2009 that Azimuth agreed to purchase notwithstanding that the purchase prices were below the minimum price of \$1.00 required by the Purchase Agreement. We negotiated a discount rate (excluding placement agent fees) of 8.86% for the sale in December of 2008 and 8.0% for the sales in September of 2009. Prior to the successful conclusion of negotiations, Azimuth was not obligated to purchase these shares. Offering expenses incurred from the inception of the Facility through 2009 related to sales to Azimuth were \$0.7 million.

Proceeds from the sale of shares under the ATM Agreement, registered direct offerings and under the equity line of credit are being used to continue development of our XOMA 052 product candidate and for other working capital and general corporate purposes.

### ***Convertible Debt***

In February of 2006, we completed an exchange offer with holders of our 6.5% convertible senior notes due 2012 in which we exchanged \$60 million aggregate principal amount of 6.5% Convertible SNAPs<sub>SM</sub> due 2012 (the "New Notes") for all \$60 million aggregate principal amount of our then outstanding convertible senior

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notes due 2012. We also issued an additional \$12 million of New Notes to the public for cash at a public offering price of 104% of principal, or \$12.5 million.

During the first quarter of 2007, holders voluntarily converted \$42 million of our New Notes and we converted the \$2.5 million of our New Notes that remained outstanding (the other \$27.5 million thereof having been converted in 2006). As a result, 25,640,187 shares were issued to effect the conversion of the principal balances. Additionally, at the time of conversion, we issued 1,889,317 shares and \$5.2 million in cash to satisfy the remaining additional interest payment feature related to these converted New Notes.

For the year ended December 31, 2007, we incurred \$0.2 million in interest expense related to our convertible debt, amortized \$0.1 million in debt issuance costs, premium and discount, and recognized \$6.1 million in interest expense related to the revaluation of the embedded derivative.

### Item 6. Selected Financial Data

The following table contains our selected financial information including consolidated statement of operations and consolidated balance sheet data for the years 2005 through 2009. The selected financial information has been derived from our audited consolidated financial statements. The selected financial information should be read in conjunction with *Item 8: Financial Statements and Supplementary Data* and *Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations* included in this Annual Report. The data set forth below is not necessarily indicative of the results of future operations.

	Year Ended December 31,				
	2009	2008	2007	2006	2005
	(In thousands, except per share amounts)				
<b>Consolidated Statement of Operations Data</b>					
Total revenues (1)	\$ 98,430	\$ 67,987	\$ 84,252	\$ 29,498	\$ 18,669
Total operating costs and expenses (2)	85,470	106,721	86,796	70,182	54,694
Loss from operations	12,960	(38,734)	(2,544)	(40,684)	(36,025)
Other income (expense), net (3)	(6,683)	(6,894)	(9,782)	(11,157)	38,807
Net income (loss) before taxes	6,277	(45,628)	(12,326)	(51,841)	2,782
Income tax expense (benefit), net (4)	5,727	(383)	—	—	3
Net income (loss)	\$ 550	\$ (45,245)	\$ (12,326)	\$ (51,841)	\$ 2,779
Basic and diluted net income (loss) per common share	\$ —	\$ (0.34)	\$ (0.10)	\$ (0.54)	\$ 0.03
	December 31,				
	2009	2008	2007	2006	2005
	(In thousands)				
<b>Balance Sheet Data</b>					
Cash and cash equivalents	\$ 23,909	\$ 9,513	\$ 22,500	\$ 28,002	\$ 20,804
Short-term investments	—	1,299	16,067	18,381	22,732
Restricted cash	—	9,545	6,019	4,330	—
Current assets	32,152	38,704	58,088	65,888	50,288
Working capital	13,474	11,712	34,488	43,221	33,744
Total assets	52,824	67,173	84,815	91,478	72,577
Current liabilities	18,678	26,992	23,600	22,667	16,544
Long-term liabilities (5)	16,620	71,582	60,897	106,984	76,706
Redeemable convertible preferences shares, at par value (6)	1	1	1	1	1
Accumulated deficit	(784,554)	(785,104)	(739,859)	(727,533)	(675,692)
Total shareholders' equity (net capital deficiency)	17,526	(31,401)	318	(38,173)	(20,673)

We have paid no dividends in the past five years.

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- (1) 2009 includes a non-recurring fee of \$28.1 million related to the expansion of our collaboration agreement with Takeda Pharmaceutical Company Limited (“Takeda”) and a non-recurring fee of \$25 million related to the sale of our LUCENTIS® royalty interest to Genentech, Inc., a member of the Roche Group (“Genentech”). 2008 includes a non-recurring fee from Novartis AG (“Novartis”) of \$13.7 million relating to a restructuring of the existing collaboration agreement. 2007 includes a non-recurring license fee from Pfizer Inc. of \$30 million.
- (2) The decrease in 2009 is due to our continued focus on cost control as well as decreased spending on certain contracts with collaborative partners. Operating expense in 2009 includes restructuring expense of \$3.6 million. Increases in 2008, 2007 and 2006 reflect increased spending on our development of XOMA 052 and XOMA 629 and our contracts with Novartis, the National Institute of Allergy and Infectious Diseases, Schering-Plough Research Institute, now a subsidiary of Merck & Co., Inc. (“Merck/Schering-Plough”), Merck/Schering-Plough/AVEO Pharmaceuticals, Inc. and Takeda.
- (3) 2009 includes a loss of \$3.6 million on debt extinguishment relating to the repayment of our term loan with Goldman Sachs Specialty Lending Holdings, Inc. (“Goldman Sachs”) and a gain of \$1.8 million recognized relating to the revaluation of our warrant liabilities in 2009. 2007 and 2006 include interest expense of \$6.1 million and \$6.9 million, respectively, related to the revaluation of the embedded derivative to fair market value and the payment in common shares, of the additional interest feature, on our convertible debt. 2005 includes a one-time gain of \$40.9 million as a result of the restructuring of the Genentech agreement in January of 2005.
- (4) 2009 includes foreign income tax expense of \$5.8 million recognized in connection with the expansion of our existing collaboration with Takeda.
- (5) The balance as of December 31, 2009 includes \$13.3 million from our Novartis note. In 2009, we repaid our term loan with Goldman Sachs. The balance as of December 31, 2008 includes \$50.4 million from our term loan with Goldman Sachs, \$12.9 million from our Novartis note, and \$8.1 million in long-term deferred revenue. In May of 2008, the Company entered into a \$55 million amended term loan facility with Goldman Sachs, paying off the remaining balance on the term loan completed in November of 2006. In addition, the outstanding principal on our Novartis note was reduced by \$7.5 million due to the restructure of our collaboration with Novartis. In 2007, we eliminated the remaining \$44.5 million in convertible debt issued in 2006. The balance as of December 31, 2007 includes \$30.3 million from our term loan with Goldman Sachs, \$20.6 million for our Novartis note, and \$10 million in long-term deferred revenue. In 2006, we exchanged convertible senior notes (issued in 2005) for \$60 million of 6.5% Convertible SNAP<sub>SSM</sub> due 2012 and issued an additional \$12 million of 6.5% SNAP<sub>SSM</sub> to the public for cash. The balance as of December 31, 2006 also includes our \$35 million term loan from Goldman Sachs completed in November of 2006. 2005 includes liabilities incurred in connection with our \$60 million aggregate principal amount of convertible senior notes due 2012 issued in February of 2005.
- (6) Aggregate liquidation preference of \$29.6 million.

## **Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations**

### **Overview**

We are a leader in the discovery, development and manufacture of therapeutic antibodies designed to treat inflammatory, autoimmune, infectious and oncological diseases. Our proprietary development pipeline includes XOMA 052, an anti-interleukin-1 beta (“IL-1 beta”) antibody, XOMA 3AB, a biodefense anti-botulism antibody candidate, and preclinical antibody discovery programs in several indications. We have a fully integrated product development platform, extending from preclinical science to development and manufacturing. We have multiple revenue streams resulting from the licensing of our antibody technologies, biodefense contracts and discovery and development collaborations and product royalties. Our technologies have contributed to the success of marketed antibody products, including LUCENTIS® (ranibizumab injection) for wet age-related macular degeneration and CIMZIA® (certolizumab pegol) for rheumatoid arthritis and Crohn’s disease.

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We have established on-going technology licensing programs for certain of our proprietary technologies, which have attracted numerous significant licensees including Bayer Healthcare AG, Johnson & Johnson (formerly Centocor, Inc.), Merck & Co., Inc. (“Merck”), Pfizer Inc. (“Pfizer”) and Takeda Pharmaceutical Company Limited (“Takeda”). We have a premier antibody discovery and development platform that includes multiple antibody discovery or phage display libraries that increase our ability and that of our partners to discover new therapeutic antibodies. Once an antibody is discovered, we use a number of proprietary technologies including our Human Engineering™, affinity maturation, bacterial cell expression and manufacturing technologies to enhance and improve the qualities of the antibodies for efficacy, safety, stability, productivity and cost. Some of XOMA’s technologies are used widely across the industry and have generated significant revenues for the company. For example, bacterial cell expression technology is a key biotechnology for the discovery and manufacture of antibodies and other proteins. Thus far, more than 50 pharmaceutical and biotechnology companies have signed bacterial cell expression licenses with us, and a number of licensed product candidates are in clinical development.

Our biodefense initiatives currently include a \$65 million multiple-year contract funded by the National Institute of Allergy and Infectious Diseases (“NIAID”), a part of the National Institutes of Health (“NIH”), to support our ongoing development of drug candidates toward clinical trials in the treatment of botulism poisoning. This contract is the third that NIAID has awarded us for the development of botulinum antitoxins and brings the program’s total awards to nearly \$100 million. We also develop products with premier pharmaceutical companies including Novartis AG (“Novartis”), Schering-Plough Research Institute, a division of Schering Corporation, now a subsidiary of Merck (referred to herein as “Merck/Schering-Plough”) and Takeda.

### **Significant Developments in 2009**

#### ***XOMA 052 and Proprietary Pipeline***

- We successfully completed the XOMA 052 Phase 1 clinical development program with the announcement of positive results in July of 2009. The results demonstrated that XOMA 052 is well tolerated at all doses evaluated with a pharmacokinetic profile that supports monthly or less frequent dosing. Further, a multiple dose regimen of XOMA 052 showed clinically meaningful reductions in diabetic measures and cardiovascular and inflammatory biomarkers.
- In October of 2009, we initiated a XOMA 052 Phase 2 development program focused on Type 2 diabetes and cardiovascular disease. The clinical trials are designed to further evaluate the use of multiple dose regimens on the safety, pharmacodynamics and efficacy of XOMA 052 in cardiometabolic and other diseases, and based on positive results, select doses for pivotal Phase 3 studies. In February of 2010, we announced that enrollment had begun in a 325-patient Phase 2 dose-ranging clinical trial of XOMA 052 in Type 2 diabetes patients. We continue ongoing discussions with a number of companies for a partnership to develop and commercialize XOMA 052.
- Other developments include the announcement of a Phase 2 clinical trial in Type 1 diabetes funded by the Juvenile Diabetes Research Foundation and the receipt of U.S. and European patent grants covering XOMA 052.

#### ***Biodefense***

- We advanced XOMA 3AB into the pre-Investigational New Drug (“IND”) stage. XOMA 3AB is a multi-antibody product that targets the most potent of the botulinum toxins, Type A. XOMA 3AB is currently being developed under a \$65 million multiple-year contract funded with federal funds from NIAID to support our ongoing development of drug candidates toward clinical trials in the treatment of botulism poisoning.
- In the third quarter of 2009, we obtained \$3.9 million in biodefense subcontract awards from SRI International for the development of antibodies to the H1N1 and H5N1 influenza viruses and the virus that causes severe acute respiratory syndrome. The subcontract awards are funded through NIAID.

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### ***Technology Licensing and Collaboration Agreements***

- We generated revenue from technology licensing and collaboration agreements of \$43.8 million in 2009. This includes the expansion of our existing collaboration with Takeda in February of 2009 to provide Takeda with access to multiple antibody technologies, in exchange for a \$29 million expansion fee, before taxes and other costs. In addition, in the second half of 2009, we entered into antibody discovery collaborations with Arana Therapeutics Limited, a wholly-owned subsidiary of Cephalon, Inc. (“Arana”), and The Chemo-Sero-Therapeutic Research Institute, a Japanese research foundation known as Kaketsuken, involving multiple proprietary XOMA antibody research and development technologies for fees of \$6 million and \$8 million, respectively.

### ***Royalties***

- We recognized royalty revenue of \$29.1 million in 2009, primarily related to the sale of our LUCENTIS® royalty interest to Genentech, Inc., a wholly-owned member of the Roche Group (referred to herein as “Genentech”), in the third quarter of 2009 for a total of \$25 million. We will no longer receive royalties on sales of LUCENTIS®.
- We received royalties of \$0.5 million in 2009 from UCB Celltech, a branch of UCB S.A. (“UCB”), on U.S. sales of CIMZIA® for the treatment of Crohn’s disease and on U.S. and Canadian sales of CIMZIA® for the treatment of moderate-to-severe rheumatoid arthritis, which was approved by the U.S. Food and Drug Administration (“FDA”) in May of 2009 and in Canada in September of 2009.
- In the first half of 2009, RAPTIVA® was withdrawn from the commercial drug markets. We previously received mid-single digit royalties on worldwide sales of RAPTIVA®, a product that we developed under a collaboration agreement with Genentech.

### ***Financial***

- In May and June of 2009, we entered into definitive agreements with certain institutional investors to sell a total of 22.2 million units, with each unit consisting of one of our common shares and a warrant to purchase 0.50 of a common share, for gross proceeds of approximately \$22 million, before deducting placement agent fees and estimated offering expenses of \$1.6 million, in two registered direct offerings. The warrants represent the right to acquire an aggregate of up to 11.1 million common shares over a five-year period at exercise prices of \$1.02 and \$1.30 per share. Subsequent to the end of 2009, the warrant holders agreed to amend certain terms of these warrants and shares were issued on exercise of the warrants issued in May of 2009, as disclosed below in the *Subsequent Events* section.
- In September of 2009, we fully repaid our term loan facility with Goldman Sachs Specialty Lending Holdings, Inc. (“Goldman Sachs”). Prior to repayment, we were not in compliance with the requirements of the relevant provisions of this loan facility, due to the cessation of royalties from sales of RAPTIVA® related to its market withdrawal in the first half of 2009. Repayment of this loan facility discharged all of our obligations to the lenders.
- In the third quarter of 2009, we raised approximately \$26.4 million in two separate financing transactions, before deducting placement agent fees and estimated offering expenses of approximately \$0.4 million, with Azimuth Opportunity Ltd. (“Azimuth”). We sold approximately 34.3 million common shares to Azimuth in these financing transactions.
- Also in the third quarter of 2009, we entered into an At Market Issuance Sales Agreement (the “ATM Agreement”), with Wm Smith & Co. (“Wm Smith”), under which we may sell up to 25 million of our common shares from time to time through Wm Smith, as the agent for the offer and sale of the common shares. From the inception of the ATM Agreement through December 31, 2009, we sold a total of 4.1 million common shares through Wm Smith for aggregate gross proceeds of \$2.9 million, before deducting offering expenses of \$0.1 million. Refer to the *Subsequent Events* section below for disclosure regarding the number of shares sold under this agreement subsequent to the end of 2009.

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### ***Other***

- In January of 2009, we announced a workforce reduction of approximately 42%, or 144 employees, a majority of which were employed in manufacturing and related support functions. This decision was made based on the challenging economic conditions and a decline in forecasted manufacturing demand in 2009. As a result, we achieved an annualized reduction in cash expenditures of approximately \$27 million. We recorded restructuring charges of \$3.6 million in 2009 related to the workforce reduction.
- In September of 2009, we received notice from The NASDAQ Stock Market (“NASDAQ”) that for the thirty consecutive business days preceding September 15, 2009, the bid price of our common shares closed below the minimum \$1.00 per share requirement under NASDAQ Listing Rule 5450(a)(1) for continued inclusion on The NASDAQ Global Market. In accordance with NASDAQ Listing Rule 5810(c)(3)(A), we have a period of 180 calendar days, or until March 15, 2010, to regain compliance with the minimum bid price requirement. We anticipate receiving a further letter from NASDAQ on or shortly after March 16, 2010 indicating that we have not regained compliance with this requirement and intend to request a hearing before a NASDAQ Listing Qualification Panel (the “Panel”), which request will stay delisting pending the Panel’s decision following the hearing. At the hearing, we intend to request continued listing based on a plan for regaining compliance. Although the Panel has authority to grant us up to an additional 180 days from the date of the forthcoming NASDAQ notice to implement our plan, there can be no assurance that the Panel will grant our request for continued listing.

### **Critical Accounting Estimates**

The accompanying discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements and the related disclosures, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates, assumptions and judgments that affect the reported amounts in our consolidated financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following policies to be the most critical to an understanding of our financial condition and results of operations because they require us to make estimates, assumptions and judgments about matters that are inherently uncertain.

#### ***Revenue Recognition***

Revenue is recognized when the four basic criteria of revenue recognition are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the fee is fixed and determinable; and (4) collectibility is reasonably assured. The determination of criteria (2) is based on management’s judgments regarding whether a continuing performance obligation exists. The determination of criteria (3) and (4) are based on management’s judgments regarding the nature of the fee charged for products or services delivered and the collectibility of those fees. Allowances are established for estimated uncollectible amounts, if any.

We recognize revenue from license and collaboration arrangements, contract services and royalties. Our revenue arrangements with multiple elements are divided into separate units of accounting if certain criteria are met, including whether the delivered element has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. The consideration we receive is allocated among the separate units based on their respective fair values and the applicable revenue recognition criteria are applied to each of the separate units. Advance payments received in excess of amounts earned are classified as deferred revenue until earned.

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### ***License and Collaborative Fees***

Revenue from non-refundable license, technology access or other payments under license and collaborative agreements where we have a continuing obligation to perform is recognized as revenue over the expected period of the continuing performance obligation. We estimate the performance period at the inception of the arrangement and reevaluate it each reporting period. This reevaluation may shorten or lengthen the period over which the remaining revenue is recognized. Changes to these estimates are recorded on a prospective basis.

Milestone payments under collaborative and other arrangements are recognized as revenue upon completion of the milestone event, once confirmation is received from the third party and collectibility is reasonably assured. This represents the culmination of the earnings process because we have no future performance obligations related to the payment. Milestone payments that require a continuing performance obligation on our part are recognized over the expected period of the continuing performance obligation. Amounts received in advance are recorded as deferred revenue until the related milestone is completed.

### ***Contract Revenue***

Contract revenue for research and development involves our providing research and development and manufacturing services to collaborative partners, biodefense contractors or others. Revenue for certain contracts is accounted for by a proportional performance, or output-based, method where performance is based on estimated progress toward elements defined in the contract. The amount of contract revenue and related costs recognized in each accounting period are based on estimates of the proportional performance during the period. Adjustments to estimates based on actual performance are recognized on a prospective basis and do not result in reversal of revenue should the estimate to complete be extended.

In addition, revenue related to certain research and development contracts is billed based on actual costs incurred by XOMA related to the contract, multiplied by full-time equivalent ("FTE") rates plus a mark-up. The FTE rates are developed based on our best estimates of labor, materials and overhead costs. For certain contracts, the FTE rates are agreed upon at the beginning of the contract and are subject to review or audit by the contracting party at any time.

For example, in the third quarter of 2008, we disclosed a change in accounting estimate as a result of an audit by the NIH of the Company's 2007 actual data, from which the NIH developed billing rates for the period from January 2007 to June 2009 to be used for all of the Company's contracts with NIAID, including Contract No. HHSN26620060008C/N01-A1-60008 ("NIAID 2"). While the audited NIH rates are considered final for 2007 billings, these NIH rates are considered provisional for the period from January of 2008 to June of 2009 and thus are subject to future audits at the discretion of NIAID's contracting office. In September of 2008, we retroactively applied these NIH rates to the invoices from 2007 through the third quarter of 2008 resulting in an adjustment to decrease revenue by \$2.7 million.

Up-front fees are recognized ratably over the expected benefit period under the arrangement. Given the uncertainties of research and development collaborations, significant judgment is required to determine the duration of the arrangement. We have \$4.5 million of deferred up-front fees related to two research and collaboration agreements that are being amortized over a range of two to five years.

### ***Royalty Revenue***

Royalty revenue and royalty receivables are generally recorded in the periods these royalties are earned, in advance of collection. The royalty revenue and receivables in these instances are based upon communication with collaborative partners, historical information and forecasted sales trends.

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### ***Research and Development Expenses***

We expense research and development expenses as incurred. Research and development expenses consist of direct costs such as salaries and related personnel costs and material and supply costs, and research-related allocated overhead costs, such as facilities costs. In addition, research and development expenses include costs related to clinical trials. Expenses resulting from clinical trials are recorded when incurred based in part on estimates as to the status of the various trials. From time to time, research and development expenses may include up-front fees and milestones paid to collaborative partners for the purchase of rights to in-process research and development. Such amounts are expensed as incurred. The timing of up-front fees and milestone payments in the future may cause variability in our future research and development expenses.

### ***Share-Based Compensation***

The valuation of share-based compensation awards is determined at the date of grant using the Black-Scholes option pricing model. This model requires inputs such as the expected term of the option, expected volatility and risk-free interest rate. Further, the forfeiture rate also impacts the amount of aggregate compensation. These inputs are subjective and generally require significant analysis and judgment to develop. To establish an estimate of expected term, we consider the vesting period and contractual period of the award and our historical experience of share option exercises, post-vesting cancellations and volatility. To establish an estimate of forfeiture rate, we consider our historical experience of option forfeitures and terminations. The risk-free rate is based on the yield available on United States Treasury zero-coupon issues. We review our valuation assumptions quarterly and, as a result, it is likely we will change our valuation assumptions used to value share-based awards granted in future periods.

Share-based compensation expense is recognized ratably over the requisite service period. If options are granted that include a performance condition, we estimate the probability of the performance condition being achieved on a quarterly basis. If it is determined that it is probable the performance criteria will be achieved, we estimate an implicit service period from grant date to the most likely date of achievement of the performance criteria and record share-based compensation expense ratably over this implicit service period. These estimates require significant judgment and may change in future periods.

### ***Income Taxes***

The application of income tax law and regulations is inherently complex. Interpretations and guidance surrounding income tax laws and regulations change over time. As such, changes in our subjective assumptions and judgments can materially affect amounts recognized in our financial statements.

We account for uncertain tax positions in accordance with Accounting Standards Codification Topic 740, *Income Taxes* ("ASC 740"). ASC 740 provides for the recognition of deferred tax assets if realization of such assets is more likely than not. Based upon the weight of available evidence, which includes our historical operating performance and carry-back potential, we have determined that total deferred tax assets should be fully offset by a valuation allowance.

### ***Long-Lived Assets***

We record impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets in the future are less than the carrying amounts of those assets. The estimate of future cash flows requires significant judgment related to potential future business opportunities being pursued by the Company.

### ***Accrued Management Incentive Compensation***

We estimate an accrual on a quarterly basis for the annual management incentive compensation plan, which is paid to employees in March of the following year. This estimate involves assessing the year's achievements on a corporate and individual employee level against our objectives set at the beginning of the year, and is subject to change each quarter.

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### *Accrued Restructuring Costs*

In the second quarter of 2009, we vacated one of our leased buildings and are currently seeking a sublease tenant. We recorded a restructuring charge in the second quarter of 2009 for the net present value of the future minimum lease payments, offset by potential future sublease payments. If the amount of sublease income changes in the future based on changes in our estimates, we will adjust the related liability for the estimated net present value of the lease.

### *Warrant Liabilities*

We issued warrants to purchase our common shares in connection with two separate registered direct offerings completed in May and June of 2009. The warrants issued included a provision allowing for an adjustment of the exercise price and number of warrant shares. This adjustment would occur if we issued or sold certain common shares in the future for a price per share less than the exercise price of the warrants in effect immediately prior to such issuance or sale. Due to this adjustment provision, the warrants did not meet the criteria set forth by Accounting Standards Codification Topic 815, *Derivatives and Hedging* ("ASC 815") and therefore were not considered indexed to our own stock.

We estimated the fair value of the warrants at the issuance dates using the Monte Carlo Simulation Model ("Simulation Model") and recorded warrant liabilities. The Simulation Model requires inputs such as the expected term of the warrants, share price volatility, risk-free interest rate and the likelihood and timing of future equity financings. These assumptions were reviewed on a quarterly basis and changes in the estimated fair value of the warrants were recognized in other income (expense).

Subsequent to the end of 2009, the warrant holders agreed to amend certain terms of these warrants, as disclosed below in the *Subsequent Events* section.

### *Loss Contingencies*

We are currently, and have been, involved in certain legal proceedings for which we assess the likelihood of any adverse judgments or outcomes for these legal matters, as well as potential ranges of probable losses. We would record an estimated loss in our statement of operations if we determined that, based on information available at the time, the loss is probable and the amount of the loss is reasonably estimable. The nature of these matters is highly uncertain and subject to change. As a result, any contingent liabilities recorded may vary on a quarterly basis, and depending on the final outcome of such legal proceedings.

## **Results of Operations**

### *Revenue*

Total revenue in 2009 was \$98.4 million, compared with \$68.0 million in 2008 and \$84.3 million in 2007 as shown in the table below (in thousands):

	Year ended December 31,		
	2009	2008	2007
License and collaborative fees	\$ 43,822	\$ 16,366	\$ 36,460
Contract and other revenue	25,492	30,473	31,057
Royalties	29,116	21,148	16,735
Total revenues	<u>\$ 98,430</u>	<u>\$ 67,987</u>	<u>\$ 84,252</u>

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### *License and Collaborative Fees*

License and collaborative fee revenue includes fees and milestone payments related to the out-licensing of our products and technologies. License and collaborative fee revenue in 2009 was \$43.8 million, compared with \$16.4 million in 2008 and \$36.5 million in 2007. The primary components of license and collaborative fee revenue in 2009 were \$28.1 million in revenue recognized related to the expansion of our collaboration agreement with Takeda in February of 2009 and \$14.1 million in total revenue, including ancillary services provided, related to two antibody discovery collaboration agreements entered into with Arana and Kaketsuken in September and October of 2009. We also recognized \$1.6 million of license and collaborative fee revenue in 2009 related to up-front fees, annual maintenance fees and milestone payments from various out-licensing arrangements.

The primary source of license and collaborative fee revenue in 2008 related to the restructuring of our product development collaboration with Novartis, which involved six development programs including the HCD122 program. Under the restructured agreement, we recognized a collaborative fee of \$13.7 million in exchange for giving Novartis control over the HCD122 program and an additional program, as well as the right to expand the development of these programs into additional indications outside of oncology. We also recognized \$1.7 million in up-front fees and annual maintenance fees relating to various out-licensing arrangements. In addition, we recognized four milestone payments totaling \$1.0 million, including two milestone payments from Pfizer relating to two different products, including the payment of \$0.5 million for the initiation of a Phase 3 clinical trial.

The primary source of license and collaborative fees in 2007 related to payments received from Pfizer and an existing technology partner totaling \$31.3 million. These payments represented initial license fees for which no remaining obligation of the Company existed. In addition, \$4.3 million in revenue was recognized during the first quarter of 2007 representing the unamortized revenue from a \$10 million up-front collaboration fee received in connection with our collaboration with Novartis (then Chiron) in February of 2004. In February of 2007, we announced that pursuant to the terms of our collaboration agreement with Novartis, the mutual exclusivity obligation to conduct antibody discovery, development and commercialization work in oncology had ended. The expiration of this mutual obligation had no impact on the existing collaboration projects which had reached the development stage and the parties could continue to collaborate on a non-exclusive basis. Prior to the expiration of the exclusivity period, the up-front fee was being amortized over the expected five-year term of the exclusivity provision, or at a rate of \$0.5 million per quarter.

The generation of future revenue related to license fees and collaborative arrangements is dependent on our ability to attract new licensees to our antibody and bacterial cell expression technologies and new collaboration partners. Depending on whether and when we obtain new licensees and partners, we expect to experience a decline from 2009 levels.

### *Contract and Other Revenue*

Contract and other revenue was \$25.5 million in 2009, compared with \$30.5 million in 2008 and \$31.1 million in 2007. This revenue includes agreements where we provide contracted research and development and manufacturing services to our collaboration partners, including Takeda, Merck/Schering-Plough and NIAID.

Contract and other revenue recognized in 2009 included \$7.6 million related to our Merck/Schering-Plough contract, compared with \$10.8 million in 2008. The decrease in revenue under this contract of \$3.2 million was due to the cessation of certain discovery and development programs under our collaboration agreement in 2009. Revenue from our Manufacturing and Technology Transfer Agreement with Novartis decreased in 2009 by \$4.1 million, from \$6.6 million in 2008 to \$2.5 million in 2009, due to the completion of the work under this agreement in the third quarter of 2009. In addition, revenue from our AVEO Pharmaceuticals, Inc. (now with Merck/Schering-Plough and referred to herein together as "Merck/Schering-Plough/AVEO") contract decreased by \$2.5 million, from \$3.2 million in 2008 to \$0.7 million in 2009, as a result of our nearing the end of the contracted service arrangement.

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These decreases in contract and other revenue in 2009 were partially offset by an increase in revenue generated under our contract with NIAID Contract No. HHSN272200800028C ("NIAID 3") of \$0.9 million, from \$4.2 million in 2008 to \$5.1 million in 2009. Additionally, we recognized \$2.8 million of unamortized deferred revenue in the fourth quarter of 2009 related to the cessation of certain discovery and development programs under our collaboration with Takeda, resulting in an increase in contract revenue recognized related to our collaboration with Takeda of \$3.1 million, from \$4.4 million in 2008 to \$7.5 million in 2009.

In the third quarter of 2009, we began work on two biodefense subcontract awards from SRI International, including a \$1.7 million award to develop novel antibody drugs against the virus that causes severe acute respiratory syndrome and a \$2.2 million award to develop a novel antibody, known as F10, that has been shown to neutralize group I influenza A viruses, including the H1N1 and H5N1 strains. The subcontract awards are funded through NIAID. Revenue recognized in 2009 relating to these subcontracts was \$0.3 million.

Contract and other revenue recognized in 2008 included \$4.2 million related to NIAID 3, which was awarded in September of 2008, and \$6.6 million relating to our Manufacturing and Technology Transfer Agreement with Novartis signed in December of 2008, and effective from July of 2008. We also recognized \$10.8 million in revenue in 2008 from our agreement with Merck/Schering-Plough, compared with \$5.7 million in 2007, and \$4.4 million in revenue in 2008 from our agreement with Takeda, compared with \$3.1 million in 2007. These increases in contract and other revenue were offset by decreases in revenue recognized from our NIAID 2 contract from \$11.3 million in 2007 to \$1.3 million in 2008, and on our Merck/Schering-Plough/AVEO contract from \$8.0 million in 2007 to \$3.2 million in 2008. These decreases are primarily due to the Company nearing the end of contracted service arrangements with NIAID 2 and Merck/Schering-Plough/AVEO. Contract revenue for 2008 also included an adjustment for NIAID 2 to decrease revenue by \$2.7 million due to a change in billing rates, as detailed above in the *Critical Accounting Estimates: Contract Revenue* section.

Based on expected increases in revenue related to our NIAID 3 contract and our subcontract awards from SRI International, partially offset by decreases in contract revenue from other collaboration partners, we expect contract and other revenue in 2010 to remain comparable to 2009 levels or slightly increase depending on the timing and level of revenue generating activity.

We defer revenue until all requirements under our revenue recognition policy are met. In 2009, we deferred \$16.2 million of revenue from five contracts including Takeda, Merck/Schering-Plough and Novartis and recognized \$28.4 million in revenue from the five contracts. In 2008, we deferred \$17.5 million of revenue from five contracts including Merck/Schering-Plough, Takeda and Novartis and recognized \$18.4 million in revenue from the five contracts. In 2007, we deferred \$23.3 million of revenue from five contracts including Merck/Schering-Plough, Merck/Schering-Plough/AVEO, Takeda and Novartis and recognized \$22.2 million in revenue from the five contracts including amortization of \$4.3 million of the \$10 million in up-front payments received from Novartis related to our February of 2004 oncology collaboration contract.

The following table shows the activity in deferred revenue for the years ended December 31, 2009, 2008 and 2007 (in thousands):

	Year ended December 31,		
	2009	2008	2007
Beginning deferred revenue	\$ 17,213	\$ 18,064	\$ 16,968
Revenue deferred	16,220	17,515	23,254
Revenue recognized	(28,425)	(18,366)	(22,158)
Ending deferred revenue	\$ 5,008	\$ 17,213	\$ 18,064

Of the \$5.0 million balance in deferred revenue at December 31, 2009, \$2.1 million is expected to be earned over the next year and the remaining \$2.9 million is expected to be earned over the next four years. Future

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amounts may be affected by additional consideration received, if any, under existing or any future licensing or other collaborative arrangements as well as changes in the estimated period of obligation or services to be provided under the arrangements.

### ***Royalties***

Revenue from royalties was \$29.1 million in 2009 compared with \$21.1 million in 2008 and \$16.7 million in 2007. The increase in royalties in 2009 was primarily due to the sale of our LUCENTIS® royalty interest to Genentech for a total of \$25 million, which included the receipt of royalties of \$2.7 million recognized in the second quarter of 2009 and an additional one-time, non-refundable payment of \$22.3 million in September of 2009. Royalties earned from sales of LUCENTIS® for the first half of 2009 were \$5.1 million. We will not receive any further royalties on sales of LUCENTIS®.

The cessation of royalties earned from sales of RAPTIVA® in the second quarter of 2009 partially offsets the increase in royalty revenue in 2009. RAPTIVA® was withdrawn from the commercial drug markets in the first half of 2009. Royalties earned from sales of RAPTIVA® in 2009 were \$1.2 million.

Royalties earned from sales of CIMZIA® were \$0.5 million in 2009, compared with \$0.1 million in 2008. CIMZIA® was approved by the FDA in May of 2009 and in Canada in September of 2009 for the treatment of moderate-to-severe rheumatoid arthritis in adults. We expect royalty revenue from sales of CIMZIA® to increase in 2010.

Royalties earned in 2008 included \$6.5 million from U.S. sales of RAPTIVA®, compared with \$6.4 million in 2007, and royalties of \$5.7 million from sales of RAPTIVA® outside the U.S., compared with \$4.2 million in 2007. In addition, royalties earned on U.S. sales of LUCENTIS® were \$4.4 million in 2008, compared with \$4.1 million in 2007, and royalties earned on sales of LUCENTIS® outside the U.S. were \$4.4 million in 2008, compared with \$1.9 million in 2007.

The increase in royalty revenue from 2007 to 2008 resulted from higher sales of LUCENTIS® and RAPTIVA® in the U.S. and worldwide. According to Genentech, U.S. sales of RAPTIVA® during 2008 were \$108 million, compared with \$107 million during 2007. According to Merck Serono, sales of RAPTIVA® outside of the U.S. during 2008 were approximately \$134 million, compared with \$106 million during 2007. According to Genentech, U.S. sales of LUCENTIS® were \$875 million during 2008 compared with \$815 million during 2007. According to Novartis, sales of LUCENTIS® outside the United States were \$886 million in 2008 compared with \$393 million during 2007.

### ***Research and Development Expenses***

Biopharmaceutical development includes a series of steps, including *in vitro* and *in vivo* preclinical testing, and Phase 1, 2 and 3 clinical studies in humans. Each of these steps is typically more expensive than the previous step, but actual timing and the cost to us depends on the product being tested, the nature of the potential disease indication and the terms of any collaborative arrangements with other companies. After successful conclusion of all of these steps, regulatory filings for approval to market the products must be completed, including approval of manufacturing processes and facilities for the product. Our research and development expenses currently include costs of personnel, supplies, facilities and equipment, consultants, third party costs and other expenses related to preclinical and clinical testing.

Research and development expenses were \$58.1 million in 2009, compared with \$82.6 million in 2008 and \$66.2 million in 2007. The decrease in research and development expense of \$24.5 million in 2009, as compared to 2008, was primarily a result of our increased focus on cost control. In addition, spending on Novartis and Merck/Schering-Plough/AVEO-related contract activities decreased in 2009 due to our reaching the end of contracted service arrangements, and spending on Merck/Schering-Plough-related contract activities decreased in 2009 due to the cessation of certain discovery and development programs under the collaboration. Spending on

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XOMA 052 decreased in 2009, as compared to 2008, due to the completion of Phase 1 clinical trial enrollment in the second quarter of 2009 slightly offset by an increase in spending in the fourth quarter of 2009 related to the initiation of the Phase 2 clinical program. In addition, spending on XOMA 629 decreased in 2009, as compared to 2008, due to the Company's decision to suspend development of this product. These decreases were partially offset by increased spending on preclinical antibody discovery programs in several indications, and on our contracts with NIAID 3, Takeda and SRI International.

The \$16.4 million increase in research and development expense in 2008, compared with 2007, primarily reflects increased spending on development of XOMA 052, including Phase 1 clinical trials, and to a lesser extent XOMA 629. In addition, we increased spending on our contracts with Novartis, Merck/Schering-Plough, NIAID 3 and Takeda. Research and development expenses also increased in 2008 related to the preclinical development of several antibodies, XOMA 3AB and upgrades made to our manufacturing plant. These increases were partially offset by a decrease in spending on NIAID 2 and Merck/Schering-Plough/AVEO-related contract activities, due to the Company nearing the end of contracted service arrangements.

Research and development expense in 2007 primarily related to spending on development of XOMA 052, including the initiation of Phase 1 clinical trials, and on the development of XOMA 629. In addition, we increased spending on our contracts with NIAID 2, Merck/Schering-Plough/AVEO, Merck/Schering-Plough and Takeda.

Salaries and related personnel costs are a significant component of research and development expenses. We recorded \$26.8 million in research and development salaries and employee-related expenses in 2009, compared with \$34.4 million in 2008 and \$31.5 million in 2007. Included in these expenses for 2009 were \$22.2 million for salaries and benefits, \$2.4 million for bonus expense and \$2.2 million for share-based compensation, which is a non-cash expense. The decrease of \$7.6 million in 2009, as compared to 2008, was due to a decrease in salaries and benefits of \$9.9 million due to the workforce reduction announced in January of 2009. In addition, share-based compensation decreased by \$0.1 million. See *Results of Operations: Share-Based Compensation* for further discussion of our share-based compensation expense. Partially offsetting this decrease in research and development personnel expense was an increase in bonus expense in 2009 of \$2.4 million. In 2008, the Company did not to pay bonuses in efforts to control spending and manage the Company's cash balance.

Included in these expenses for 2008 were \$32.1 million for salaries and benefits and \$2.3 million for share-based compensation, which is a non-cash expense, compared with \$27.9 million and \$1.0 million, respectively, in 2007. The \$2.9 million increase in salaries and employee-related expenses in 2008, as compared to 2007, primarily related to increased headcount. Partially offsetting the 2008 increase in salaries and employee-related expenses was a decrease in bonus expense for 2008 to zero compared with \$2.6 million in 2007. As discussed above, the Company did not to pay bonuses for 2008.

Our research and development activities can be divided into earlier stage programs and later stage programs. Earlier stage programs include molecular biology, process development, pilot-scale production and preclinical testing. Also included in earlier stage programs are costs related to excess manufacturing capacity, which we expect will decrease in 2010 due to the consolidation of facilities. Later stage programs include clinical testing, regulatory affairs and manufacturing clinical supplies. The costs associated with these programs approximate the following (in thousands):

	Year ended December 31,		
	2009	2008	2007
Earlier stage programs	\$ 42,961	\$ 62,872	\$ 57,027
Later stage programs	15,170	19,704	9,188
Total	<u>\$ 58,131</u>	<u>\$ 82,576</u>	<u>\$ 66,215</u>

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Our research and development activities can also be divided into those related to our internal projects and those projects related to collaborative and contract arrangements. The costs related to internal projects versus collaborative and contract arrangements approximate the following (in thousands):

	Year ended December 31,		
	2009	2008	2007
Internal projects	\$ 42,206	\$ 58,468	\$ 45,804
Collaborative and contract arrangements	15,925	24,108	20,411
Total	<u>\$ 58,131</u>	<u>\$ 82,576</u>	<u>\$ 66,215</u>

In 2009 and 2008, our largest development program (XOMA 052) accounted for more than 20% but less than 30% of our total research and development expense. In 2009, one development program (NIAID) accounted for more than 10% but less than 20% of our total research and development expense, and in 2008, one development program (Novartis) accounted for more than 10% but less than 20% of our total research and development expense. No development program accounted for more than 30% of our total research and development expense in 2009 or 2008. In 2007, two development programs (XOMA 052 and NIAID) each individually accounted for more than 10% but less than 20% of our total research and development expense. No development program accounted for more than 20% of our total research and development expense in 2007.

We expect our research and development spending in 2010 will increase due to the initiation of our Phase 2 clinical program for XOMA 052 in Type 2 diabetes and cardiovascular disease and in support of our biodefense contracts. We continue ongoing discussions with a number of companies for a partnership to develop and commercialize XOMA 052.

Future research and development spending may also be impacted by potential new licensing or collaboration arrangements, as well as the termination of existing agreements. Beyond this, the scope and magnitude of future research and development expenses are difficult to predict at this time.

### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses include salaries and related personnel costs, facilities costs and professional fees. In 2009, selling, general and administrative expenses were \$23.7 million compared with \$24.1 million in 2008 and \$20.6 million in 2007. The \$0.4 million decrease in selling, general and administrative expenses in 2009 as compared with 2008 was primarily related to a decrease in salaries and related personnel costs of \$0.6 million, as further discussed below, as well as a decrease in professional fees and other expenses of \$1.2 million due to our increased focus on cost control. Partially offsetting these decreases was an increase in fees in 2009 of \$1.4 million related to the restructuring negotiations and repayment of the Goldman Sachs term loan discussed in further detail below in the *Liquidity and Capital Resources* section.

The \$3.5 million increase in selling, general and administrative expenses in 2008 as compared with 2007 was primarily related to a \$1.2 million increase in legal fees supporting our technology licensing and collaboration agreements as well as the protection of our intellectual property, a \$1.1 million increase in spending related to the marketing and communication of our technology and proprietary products to potential corporate partners and investors, a \$0.9 million increase in consulting fees primarily related to employee training and system implementation and a net increase in salaries and related expenses of \$0.6 million.

We recorded salaries and employee-related expenses of \$12.7 million in 2009 compared with \$13.3 million in 2008 and \$12.7 million in 2007. The decrease of \$0.6 million in 2009 as compared to 2008 was due to a decrease in salaries and benefits of \$1.5 million primarily due to the workforce reduction announced in January of 2009, and a decrease in share-based compensation of \$0.4 million. See *Results of Operations: Share-Based Compensation* for further discussion of our share-based compensation expense. Partially offsetting this decrease in selling, general and administrative personnel expense was an increase in bonus expense in 2009 of \$1.3 million. In 2008, the Company did not to pay bonuses in efforts to control spending and manage the Company's cash balance.

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The \$0.6 million increase in salaries and employee-related expenses in 2008 as compared to 2007 primarily related to increased headcount. Salaries and benefits expense increased by \$1.2 million in 2008 and share-based compensation increased by \$0.8 million. See *Results of Operations: Share-Based Compensation* for further discussion of our share-based compensation expense. Partially offsetting the increase in selling, general and administrative personnel expense was a decrease in bonus expense for 2008 to zero compared with \$1.4 million in 2007. As discussed above, the Company did not to pay bonuses for 2008.

We expect selling, general and administrative expenses in 2010 will be comparable to 2009 levels.

### **Restructuring Charges**

In January of 2009, we announced a workforce reduction of approximately 42%. As part of this workforce reduction, we recorded charges of \$3.1 million during 2009 related to severance, other termination benefits and outplacement services. In the third quarter of 2009, employee severance and other termination benefits related to the January of 2009 workforce reduction were fully paid. We do not expect to incur any additional restructuring charges for employee severance and other termination benefits related to the January of 2009 workforce reduction.

As a result of the workforce reduction, in the second quarter of 2009, we vacated one of our leased buildings resulting in a restructuring charge of \$0.5 million. This charge was primarily related to the net present value of the future minimum lease payments, less the estimated future sublease income. We are currently seeking a sublease tenant. At the end of 2009, one building remains temporarily vacant, in order to optimize our facility usage. As manufacturing demand increases in the future, we plan to resume operations at this facility. As of December 31, 2009, we performed an analysis of the long-lived assets related to the vacant building, with an approximate net book value of \$4.2 million. Based on estimated undiscounted future cash inflows, we have determined that there is no current impairment relating to these assets, and will continue to assess for impairment at each future reporting period.

### **Other Income (Expense)**

Investment and interest income was \$49,000 in 2009 compared with \$0.9 million in 2008 and \$1.9 million in 2007. Investment and interest income consists primarily of interest earned on our cash and investment balances. The differences between 2009, 2008 and 2007 balances resulted from varying average cash and investment balances and interest rates.

Interest expense and amortization of debt issuance costs for the Goldman Sachs term loan, to the date of repayment, and Novartis note are shown below for 2009, 2008 and 2007 (in thousands):

	Year ended December 31,		
	2009	2008	2007
<b>Interest expense</b>			
Goldman Sachs term loan	\$ 3,932	\$ 5,095	\$ 3,360
Novartis note	455	1,181	1,329
Convertible debt	—	—	6,452
Other	14	—	—
Total interest expense	\$ 4,401	\$ 6,276	\$ 11,141
<b>Amortization of debt issuance costs</b>			
Goldman Sachs term loan	\$ 487	\$ 726	\$ 444
Total amortization of debt issuance costs	\$ 487	\$ 726	\$ 444
<b>Total interest expense</b>	<u>\$ 4,888</u>	<u>\$ 7,002</u>	<u>\$ 11,585</u>

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Interest expense was \$4.9 million in 2009, compared with \$7.0 million in 2008 and \$11.6 million in 2007. The decrease in interest expense in 2009 of \$2.1 million as compared to 2008 was due to a decrease in interest expense and amortization of debt issuance costs on the Goldman Sachs term loan of \$1.4 million. This decrease was due to the repayment in full of the term loan facility in September of 2009, at which point the remaining debt issuance costs of \$1.1 million were recognized as part of the loss on debt extinguishment in our consolidated statement of operations for 2009. In addition, interest expense related to the Novartis note decreased by \$0.7 million in 2009 due to a decrease in the average principal balance and interest rate of this note. Refer to the *Liquidity and Capital Resources: Goldman Sachs Term Loan* section for additional disclosure regarding the loan repayment.

The decrease in interest expense of \$4.6 million in 2008 compared to 2007 is primarily due to the elimination of our convertible debt in 2007, which represented \$6.5 million of interest expense in 2007, including \$6.1 million related to the revaluation to fair value of the embedded derivative on our convertible debt. This decrease was partially offset by an increase in interest expense and amortization of debt issuance costs on our term loan with Goldman Sachs of \$2.0 million related to a higher principal balance and interest rate.

Interest expense for 2010 is expected to decrease compared to 2009 due to the repayment in full of our Goldman Sachs term loan in 2009. This anticipated decrease may be offset by additional interest expense in the event new debt financing is obtained.

Loss on debt extinguishment was \$3.6 million in 2009 relating to the repayment of our Goldman Sachs term loan. This loss included a prepayment premium of \$2.5 million and the recognition of unamortized debt issuance costs of \$1.1 million. In 2008, we recognized a loss on debt extinguishment of \$0.7 million reflecting the recognition of the unamortized debt issuance costs related to the original Goldman Sachs term loan, upon refinancing of the loan in May of 2008. To conform to the current period presentation, the loss recognized on debt extinguishment in 2008 was reclassified from interest expense as a separate line item. This reclassification had no impact on our previously reported net earnings (losses), financial position or cash flows.

Other income (expense) was \$1.8 million in 2009 compared with (\$0.1) million in 2008 and (\$0.1) million in 2007. The increase in other income in 2009 primarily related to gains of \$1.8 million recognized from the revaluation of our warrant liabilities in 2009. See *Results of Operations: Warrants Revaluation* below for additional disclosure.

### ***Warrants Revaluation***

We issued warrants to purchase our common shares in connection with two separate registered direct offerings completed in May and June of 2009. Refer to *Liquidity and Capital Resources: Other Equity Financings and Arrangements* for additional disclosure relating to these financing transactions.

The warrants issued included a provision allowing for an adjustment of the exercise price and number of warrant shares. This adjustment would occur if we issued or sold certain common shares in the future for a price per share less than the exercise price of the warrants in effect immediately prior to such issuance or sale. Due to this adjustment clause, these warrants were not considered indexed to our stock and were therefore subject to liability and fair value re-measurement.

The fair values of the warrants at the issuance dates were estimated using the Simulation Model, and we recorded liabilities of \$2.9 million and \$3.6 million for the May and June warrant issuances, respectively. We revalued the warrants quarterly and recorded decreases in the fair value of the warrants of \$1.8 million in 2009.

Subsequent to the end of 2009, the warrant holders agreed to amend certain terms of these warrants, as disclosed below in the *Subsequent Events* section.

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### ***Income Taxes***

We recognized \$5.7 million in income tax expense in 2009 compared with an income tax benefit of \$0.4 million in 2008. Income tax expense in 2009 is primarily related to \$5.8 million of foreign income tax expense recognized in connection with the expansion of our existing collaboration with Takeda signed in February of 2009. We were paid a \$29 million expansion fee, of which \$5.8 million was withheld for payment to the Japanese taxing authority. We also recognized \$0.1 million of income tax benefit for 2009 relating to research and development refundable credits, in addition to the \$0.4 million in research and development refundable credits recognized in 2008. There was no income tax expense for 2007.

Accounting Standards Codification Topic 740, *Income Taxes* ("ASC 740") provides for the recognition of deferred tax assets if realization of such assets is more likely than not. Based upon the weight of available evidence, which includes our historical operating performance and carry-back potential, we have determined that total deferred tax assets should be fully offset by a valuation allowance.

We have recorded cumulative gross deferred tax assets of \$189.9 million and \$214.7 million at December 31, 2009 and 2008, respectively, principally attributable to the timing of the deduction of certain expenses associated with certain research and development expenses, net operating loss and other carry-forwards. We also recorded corresponding valuation allowances of \$189.9 million and \$214.7 million at December 31, 2009 and 2008, respectively, to offset these deferred tax assets, as management cannot predict with reasonable certainty that the deferred tax assets to which the valuation allowances relate will be realized.

As of December 31, 2009, we had federal net operating loss carry-forwards of approximately \$113 million to offset future taxable income. We also had federal research and development tax credit carry-forwards of approximately \$9.4 million. In 2009, we experienced an "ownership change" under Section 382 of the Internal Revenue Code, which subjects the amount of federal and state tax carry-forwards that can be utilized to an annual limitation, which will substantially limit our future use of these carry-forwards per year. To the extent we do not utilize our carry-forwards within the applicable statutory carry-forward periods, either because of Section 382 limitations or the lack of sufficient taxable income, the carry-forwards will expire unused.

We did not have unrecognized tax benefits as of December 31, 2009 and do not expect this to change significantly over the next twelve months. In accordance with ASC 740, we will recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of December 31, 2009, we have not accrued interest or penalties related to uncertain tax positions.

### ***Share-Based Compensation***

In February of 2009, our Board of Directors approved a company-wide grant of 4,730,000 share options, of which 4,568,000 were issued as part of our annual incentive compensation package. These options vest monthly over four years and include an acceleration clause based on meeting certain performance measures. In the third quarter of 2009, management determined that it was probable that the performance measures would be achieved. We accelerated expense recognition related to these options, with an estimated implicit service period of twelve months from the grant date, which was subsequently extended an additional twelve months in the fourth quarter of 2009 based on revised assumptions.

In 2009, we recognized \$4.4 million in share-based compensation expense, compared with \$4.9 million in 2008 and \$2.9 million in 2007. The decrease in share-based compensation expense of \$0.5 million in 2009, as compared to 2008, was primarily due to a decline in outstanding options as a result of the workforce reduction in January of 2009. Partially offsetting this decrease was the accelerated expense recognition related to the annual grants in February of 2009, as discussed above.

The increase in share-based compensation expense in 2008 of \$2.0 million, as compared to 2007, primarily related to the annual grants in October of 2007 and February of 2008 that were subject to shareholder approval, which was obtained in May of 2008, at which point share-based compensation expense was recognized from grant date to approval date.

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As of December 31, 2009, there was \$6.8 million of unrecognized share-based compensation expense related to unvested share options with a weighted average remaining recognition period of 2.3 years.

### **Liquidity and Capital Resources**

Cash, cash equivalents and short-term investments at December 31, 2009 were \$23.9 million compared with \$10.8 million at December 31, 2008. Net cash provided by operating activities was \$7.4 million in 2009, compared with net cash used in operating activities of \$33.0 million in 2008 and net cash provided by operating activities of \$4.5 million in 2007.

The \$40.4 million increase in cash provided by operations from 2008 to 2009 was primarily due to the receipt of \$23.2 million in the first quarter of 2009 related to the expansion of our existing collaboration with Takeda, the receipt of \$22.3 million in the third quarter of 2009 related to the sale of our LUCENTIS® royalty interest to Genentech and the receipt of \$10 million in the second half of 2009 related to two antibody discovery collaboration agreements entered into with Arana and Kaketsuken.

In addition, receivables decreased by \$9.5 million in 2009 due to the cessation of LUCENTIS® and RAPTIVA® royalty revenue and a decline in contract revenue. The increases in cash were partially offset by a net decrease in the accounts payable and accrued liabilities balance of \$2.8 million in 2009 related to the pay down of the accounts payable balance throughout the year and our continued focus on cost control, offset by the accrual of the 2009 employee bonus, restructuring charges and an increase in professional and other fees payable. Also offsetting the increase in cash was a decrease in deferred revenue of \$12.2 million in 2009 related to a decline in advance billings and the recognition of the remaining deferred revenue related to upfront fees received for discontinued programs with Merck/Schering-Plough and Takeda.

We expect net cash provided by operating activities to decrease in 2010 due to the expected increase in research and development spending to advance XOMA 052, partially offset by cash generated from our biodefense contracts.

The \$37.5 million increase in cash used for operations from 2007 to 2008 included a net loss of \$45.2 million offset by non-cash adjustments of \$16.1 million, primarily related to depreciation and share-based compensation. In addition, receivables increased by \$4.6 million in 2008 primarily related to work performed on the NIAID 3, Novartis, Merck/Schering-Plough and Takeda contracts, offset by a decrease in work performed on the Merck/Schering-Plough/AVEO contract and accrued liabilities decreased by \$3.3 million primarily related to the reversal of the 2008 bonus accrual in the fourth quarter when the Company decided it would not pay 2008 bonuses. These decreases in cash were partially offset by an increase in the accounts payable balance of \$3.0 million due to the Company paying vendors on longer terms and an increase in other liabilities of \$2.1 million related to the NIAID 2 billing adjustment (as detailed above in the *Critical Accounting Estimates: Contract Revenue* section) for which a credit was provided to the NIH to be applied to future work performed on the NIAID 2 contract.

Cash provided by operations for 2007 consisted of a net loss of \$12.3 million offset by non-cash adjustments of \$12.4 million, primarily related to depreciation, the revaluation of our embedded derivative and interest paid on our convertible debt, and share-based compensation. In addition, the accounts payable balance increased by \$2.8 million and deferred revenue increased by \$1.1 million. During 2007, we made payments of \$6.6 million for interest on our convertible debt, \$3.1 million for interest on our Goldman Sachs term loan, and \$1.0 million for our Incentive Plans. In October of 2007, the Board of Directors approved amendments to the Incentive Plans eliminating the provisions requiring payments to be made partly in Common Shares and beginning in 2008, bonuses awarded under the incentive plans are paid entirely in cash.

Net cash provided by investing activities was \$10.6 million in 2009, compared with \$3.2 million in 2008 and net cash used in investing activities of \$8.8 million in 2007. Cash provided by investing activities in 2009

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primarily consisted of a decrease in the restricted cash balance of \$9.5 million due to use of the funds for the repayment of our Goldman Sachs term loan in September of 2009. In addition, we received proceeds from maturities of investments of \$1.3 million.

Net cash provided by investing activities of \$3.2 million in 2008 consisted of net sales and maturities of investments of \$14.8 million, partially offset by the transfer to restricted cash of \$3.5 million relating to our term loan facility with Goldman Sachs and purchases of fixed assets of \$8.1 million, primarily relating to lab and production equipment. Net cash used in investing activities of \$8.8 million in 2007 consisted of purchases of fixed assets of \$9.5 million and net proceeds from short-term investments of \$2.3 million. In addition, \$1.7 million was transferred to restricted cash in 2007 related to our term loan facility with Goldman Sachs.

Net cash used in financing activities was \$3.6 million for 2009, compared with net cash provided by financing activities of \$16.8 million in 2008 and net cash used in financing activities of \$1.2 million in 2007. Cash used in financing activities in 2009 related to the repayment in full of the Goldman Sachs term loan, including a principal payment of \$8.4 million in the second quarter of 2009, repayment of the remaining outstanding balance of \$42 million in September of 2009 and payment of a prepayment premium of \$2.5 million, partially offset by proceeds of \$49.3 million received from the issuance of common shares in 2009.

Net cash provided by financing activities in 2008 of \$16.8 million related to the refinancing of our original loan facility with Goldman Sachs in May of 2008, which netted proceeds of approximately \$30.9 million, partially offset by a principal payment of \$8.2 million against the outstanding balance of the original facility with Goldman Sachs in the first quarter of 2008. In addition, principal payments of \$4.6 million on the new Goldman Sachs facility and \$8.9 million on our Novartis note were made in the fourth quarter of 2008. We also received proceeds of \$7.6 million from the issuance of common shares related to draws made on our equity line of credit with Azimuth.

Net cash used by financing activities in 2007 of \$1.2 million included a \$4.7 million principal repayment on our Goldman Sachs term loan, offset by additional borrowings of \$2.8 million on our Novartis note and \$0.7 million in proceeds received from the issuance of common shares.

### *Goldman Sachs Term Loan*

In September of 2009, we fully repaid our term loan facility with Goldman Sachs, which was a five-year term loan facility originally entered into in November of 2006 and refinanced in May of 2008. Prior to repayment, we were not in compliance with the requirements of the relevant provisions of this loan facility, due to the cessation of royalties from sales of RAPTIVA® related to its market withdrawal in the first half of 2009. Repayment of this loan facility discharged all of our obligations to the lenders.

We repaid the outstanding principal balance of \$42 million, accrued interest to the date of payment of \$2.4 million and a prepayment premium of \$2.5 million. In the third quarter of 2009, we recorded a loss on repayment of debt of \$3.6 million, which included the prepayment premium and the recognition of the unamortized debt issuance costs of \$1.1 million. This loss was recorded as loss on debt extinguishment in our consolidated statement of operations for 2009.

### *Novartis Note*

In May of 2005, we executed a secured note agreement with Novartis (then Chiron Corporation), which is due and payable in full in June of 2015. Under the note agreement, we borrowed semi-annually to fund up to 75% of our research and development and commercialization costs under our collaboration arrangement with Novartis, not to exceed \$50 million in aggregate principal amount. As of December 31, 2009, the interest rate was 2.44%. At our election, the semi-annual interest payments can be added to the outstanding principal amount, in lieu of a cash payment, as long as the aggregate principal amount does not exceed \$50 million and we have made this election for all interest payments thus far. Loans under the note agreement are secured by our interest in the collaboration with Novartis, including any payments owed to us thereunder.

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In November of 2008, we restructured our product development collaboration with Novartis. Pursuant to this restructuring, we will not make any additional borrowings on our Novartis note.

At December 31, 2009, the outstanding principal balance under this note agreement was \$13.3 million and for the years ended December 31, 2009, 2008 and 2007 we incurred, and added to the principal balance of the note, interest expense of \$0.5 million, \$1.2 million and \$1.3 million, respectively.

### *Equity Line of Credit*

On October 21, 2008, we entered into a common share purchase agreement (the "Purchase Agreement") with Azimuth, pursuant to which we obtained a committed equity line of credit facility (the "Facility") under which we could sell up to \$60 million of our registered common shares to Azimuth over a 24-month period, subject to certain conditions and limitations. The Purchase Agreement required a minimum share price of \$1.00 per share to allow us to issue shares to Azimuth under the Facility. However, at its election, Azimuth could buy shares below the threshold price at a negotiated discount. We were not obligated to utilize any of the \$60 million Facility and remained free to enter other financing transactions. Shares under the Facility were sold pursuant to a prospectus which forms a part of a registration statement declared effective by the Securities and Exchange Commission on May 29, 2008. At the end of the third quarter of 2009, the Facility is no longer in effect, and no additional shares can be issued thereunder.

From the inception of the Facility through 2009, we have sold a total of 42,228,428 common shares to Azimuth for aggregate gross proceeds of \$33.9 million. This included the sale of 34.3 million shares in two transactions in September of 2009 that Azimuth agreed to purchase notwithstanding that the purchase prices were below the minimum price of \$1.00 required by the Purchase Agreement. We negotiated a discount rate (excluding placement agent fees) of 8.0% for those transactions. Prior to the successful conclusion of negotiations, Azimuth was not obligated to purchase these shares. Offering expenses incurred in 2009 related to sales to Azimuth were \$0.4 million.

### *Other Equity Financings and Arrangements*

In May of 2009, we entered into a definitive agreement with an institutional investor to sell 11,764,706 units, with each unit consisting of one of our common shares and a warrant to purchase 0.50 of a common share, for gross proceeds of approximately \$10 million, before deducting placement agent fees and estimated offering expenses of \$0.8 million, in a registered direct offering. The investor purchased the units at a price of \$0.85 per unit. The warrants, which represent the right to acquire an aggregate of up to 5,882,353 common shares, were exercisable at any time on or after May 15, 2009 and prior to May 20, 2014 at an exercise price of \$1.02 per share. As of December 31, 2009, all warrants issued in May of 2009 remained outstanding.

In June of 2009, we entered into a definitive agreement with certain institutional investors to sell 10,434,782 units, with each unit consisting of one of our common shares and a warrant to purchase 0.50 of a common share, for gross proceeds of approximately \$12 million, before deducting placement agent fees and estimated offering expenses of \$0.8 million, in a second registered direct offering. The investor purchased the units at a price of \$1.15 per unit. The warrants, which represent the right to acquire an aggregate of up to 5,217,391 common shares, are exercisable at any time on or prior to December 10, 2014 at an exercise price of \$1.30 per share. As of December 31, 2009, all warrants issued in June of 2009 remained outstanding.

Subsequent to the end of 2009, the warrant holders agreed to amend certain terms of these warrants and shares were issued on exercise of the warrants issued in May of 2009, as disclosed below in the *Subsequent Events* section.

In the third quarter of 2009, we entered into the ATM Agreement, with Wm Smith, under which we may sell up to 25 million of our common shares from time to time through Wm Smith, as the agent for the offer and sale of the common shares. Wm Smith may sell these common shares by any method permitted by law deemed to

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be an “at the market” offering as defined in Rule 415 of the Securities Act of 1933, including but not limited to sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. Wm Smith may also sell the common shares in privately negotiated transactions, subject to our approval. We pay Wm Smith a commission equal to 3% of the gross proceeds of all common shares sold through it as sales agent under the ATM Agreement but in no event less than \$0.02 per share. Shares sold under the ATM Agreement are sold pursuant to a prospectus which forms a part of a registration statement declared effective by the Securities and Exchange Commission on May 29, 2008. From the inception of the ATM Agreement through December 31, 2009, we sold a total of 4,050,617 common shares through Wm Smith for aggregate gross proceeds of \$2.9 million. Total offering expenses related to these sales were \$0.1 million. Refer to the *Subsequent Events* section below for disclosure regarding the number of shares sold under this agreement subsequent to the end of 2009.

Proceeds from the sale of shares under the equity line of credit, ATM Agreement, registered direct offerings and other equity offerings are being used to continue development of our XOMA 052 product candidate and for other working capital and general corporate purposes. We also used the proceeds to repay the Goldman Sachs term loan in September of 2009.

### *Convertible Debt*

In February of 2006, we completed an exchange offer with holders of our 6.5% convertible senior notes due 2012 in which we exchanged \$60 million aggregate principal amount of 6.5% Convertible SNAPs<sub>SM</sub> due 2012 (the “New Notes”) for all \$60 million aggregate principal amount of our then outstanding convertible senior notes due 2012. We also issued an additional \$12 million of New Notes to the public for cash at a public offering price of 104% of principal, or \$12.5 million.

In the first quarter of 2007, holders voluntarily converted \$42 million of our New Notes and we converted the \$2.5 million of our New Notes that remained outstanding (the other \$27.5 million thereof having been converted in 2006). As a result, 25,640,187 shares were issued to effect the conversion of the principal balances. Additionally, at the time of conversion, we issued 1,889,317 shares and \$5.2 million in cash to satisfy the remaining additional interest payment feature related to these converted notes.

For the year ended December 31, 2007, we incurred \$0.2 million in interest expense related to our convertible debt, amortized \$0.1 million in debt issuance costs, premium and discount, and recognized \$6.1 million in interest expense related to the revaluation of the embedded derivative.

\* \* \*

We have incurred significant operating losses and negative cash flows from operations since our inception. At December 31, 2009, we had cash and cash equivalents of \$23.9 million. During 2010, we expect to continue using our cash and cash equivalents to fund ongoing operations. Additional licensing, antibody discovery and development collaboration agreements, government funding and financing arrangements may positively impact our cash balances. Based on our cash reserves and anticipated spending levels, revenue from collaborations including a XOMA 052 corporate partnership, licensing transactions or biodefense contracts and other sources of funding we believe to be available, we estimate that we have sufficient cash resources to meet our anticipated net cash needs through the next twelve months. Any significant revenue shortfalls, increases in planned spending on development programs or more rapid progress of development programs than anticipated, as well as the unavailability of anticipated sources of funding, could shorten this period. If adequate funds are not available, we will be required to delay, reduce the scope of, or eliminate one or more of our product development programs and further reduce personnel-related costs. Progress or setbacks by potentially competing products may also affect our ability to raise new funding on acceptable terms.

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### Commitments and Contingencies

#### Schedule of Contractual Obligations

Payments by period due under contractual obligations at December 31, 2009 are as follows (in thousands):

<u>Contractual Obligations</u>	<u>Total</u>	<u>Less than 1 year</u>	<u>1 to 3 years</u>	<u>3 to 5 years</u>	<u>More than 5 years</u>
Operating leases	\$19,244	\$ 5,307	\$ 10,237	\$ 3,700	\$ —
Debt Obligations (a)					
Principal	13,341	—	—	—	13,341
Interest	1,787	325	650	650	162
Total	<u>\$34,372</u>	<u>\$ 5,632</u>	<u>\$ 10,887</u>	<u>\$ 4,350</u>	<u>\$ 13,503</u>

- (a) See *Item 7A: Quantitative and Qualitative Disclosures about Market Risk* and *Note 7: Long-Term Debt and Other Arrangements* to the accompanying consolidated financial statements for further discussion of our debt obligation.

In addition to the above, we have committed to make potential future “milestone” payments to third parties as part of licensing and development programs. Payments under these agreements become due and payable only upon the achievement of certain developmental, regulatory and/or commercial milestones. Because it is *uncertain* if and when these milestones will be achieved, such contingencies, aggregating up to \$79 million have not been recorded on our consolidated balance sheet. We are also obligated to pay royalties, ranging generally from 1.5% to 5% of the selling price of the licensed component and up to 40% of any sublicense fees to various universities and other research institutions based on future sales or licensing of products that incorporate certain products and technologies developed by those institutions. We are unable to determine precisely when and if our payment obligations under the agreements will become due as these obligations are based on future events, the achievement of which is subject to a significant number of risks and uncertainties.

Although operations are influenced by general economic conditions, we do not believe that inflation had a material impact on financial results for the periods presented. We believe that we are not dependent on materials or other resources that would be significantly impacted by inflation or changing economic conditions in the foreseeable future.

### Recent Accounting Pronouncements

In June of 2009, the Financial Accounting Standards Board (“FASB”) established the FASB Accounting Standards Codification (the “ASC”) as the source of authoritative accounting principles recognized by the FASB. The FASB will issue new standards in the form of Accounting Standards Updates (“ASU”). The ASC is effective for financial statements issued for interim and annual periods ending after September 15, 2009 and therefore was effective for us in the third quarter of 2009. The issuance of the ASC does not change U.S. generally accepted accounting principles (“GAAP”) and therefore the adoption of the ASC only affects the specific references to GAAP literature in the notes to our consolidated financial statements.

Accounting Standards Codification Topic 855, *Subsequent Events* (“ASC 855”) establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. In particular, ASC 855 sets forth the period after the balance sheet date during which management should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. The new provisions of ASC 855 were effective for interim financial reporting periods ending after June 15, 2009 and did not have a material effect on our financial statements.

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Accounting Standards Codification Topic 320, *Investments—Debt and Equity Securities* (“ASC 320”) contains an amendment to make previous guidance regarding other-than-temporary impairments more operational and to improve the presentation of other-than-temporary impairments in the financial statements. This amendment replaces the existing requirement that management assert it has both the intent and ability to hold an impaired debt security until recovery with a requirement that management assert it does not have the intent to sell the security and it is more likely than not it will not have to sell the security before recovery of its cost basis. ASC 320 requires increased and more frequent disclosures regarding expected cash flows, credit losses, and an aging of securities with unrealized losses. The amended provisions of ASC 320 were effective for interim financial reporting periods ending after April 1, 2009 and did not have a material effect on our financial statements.

Accounting Standards Codification Topic 808, *Collaborative Arrangements* (“ASC 808”) defines collaborative arrangements and establishes reporting requirements for transactions between participants and third parties in a collaborative arrangement. ASC 808 prohibits companies from applying the equity method of accounting to activities performed outside a separate legal entity by a virtual joint venture. Instead, revenue and costs incurred with third parties in connection with the collaborative arrangement should be presented gross or net by the collaborators based on the criteria in Accounting Standards Codification Topic 605, *Revenue Recognition* (“ASC 605”), and other applicable accounting literature. The new provisions of ASC 808 should be applied to collaborative arrangements in existence at the date of adoption using a modified retrospective method that requires reclassification in all periods presented for those arrangements still in effect at the transition date, unless that application is impracticable. Effective January 1, 2009 we adopted the new provisions of ASC 808, which did not have a material effect on our financial statements. As a result of the restructuring in November of 2008 of our collaboration agreement with Novartis, this collaboration agreement is no longer within the scope of ASC 808. As of December 31, 2009, we do not have any collaboration agreements that fall under the scope of ASC 808.

Accounting Standards Codification Topic 815, *Derivatives and Hedging* (“ASC 815”) clarifies how to determine whether certain instruments or features are indexed to an entity’s own stock. This provision of ASC 815 applies to any free standing financial instrument or embedded feature that has all the characteristics of a derivative, as defined in ASC 815. Effective January 1, 2009, we adopted the relevant provisions of ASC 815. Refer to the *Critical Accounting Estimates—Warrant Liabilities* section above for the effect this adoption had on our financial statements.

Accounting Standards Codification Topic 820, *Fair Value Measurements and Disclosures* (“ASC 820”) defines fair value and establishes a framework for measuring the fair value of financial assets and liabilities. Effective January 1, 2009, we adopted the provisions of ASC 820, as it relates to non-financial assets and non-financial liabilities, which did not have a material effect on our financial statements.

Accounting Standards Update No. 2009-13, Revenue Recognition Topic 605: *Multiple Deliverable Revenue Arrangements—A Consensus of the FASB Emerging Issues Task Force* provides application guidance on whether multiple deliverables exist, how the deliverables should be separated and how the consideration should be allocated to one or more units of accounting. This update establishes a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence, if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific or third-party evidence is available. We will adopt this guidance from January 1, 2011. We are assessing the impact of this guidance on our consolidated results of operations and financial condition.

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### **Subsequent Events**

#### ***Underwritten Offering***

On February 2, 2010, we entered into an underwritten offering with investors to sell 42 million units, with each unit consisting of one of our common shares and a warrant to purchase 0.45 of a common share, for gross proceeds of approximately \$21 million, before deducting underwriting discounts and commissions and estimated offering expenses of \$1.7 million. The investors purchased the units at a price of \$0.50 per unit. The warrants, which represent the right to acquire an aggregate of up to 18.9 million common shares, are exercisable beginning six months and one day after issuance and have a five-year term and an exercise price of \$0.70 per share.

#### ***Warrant Amendments and Exercises***

Also on February 2, 2010, we agreed to amend the terms of the warrants issued in May and June of 2009 to eliminate the provisions that would have required reduction of the warrant exercise price and an increase in the number of shares issuable on exercise of the warrants each time we sold common shares at a price less than the exercise price of such warrants. In return, the exercise price of the warrants issued in May of 2009 was reduced to from \$1.02 per share to \$0.001 per share and we made a \$4.5 million payment to holders of the warrants issued in June of 2009. The exercise price of the warrants issued in June of 2009 remains unchanged at \$1.30 per share. In February of 2010, the holders of warrants issued in May of 2009 exercised warrants to acquire 5,882,353 common shares for an aggregate exercise price of \$5,882, and as a result no warrants issued in May of 2009 remain outstanding.

#### ***Common Shares Sold Under the ATM Agreement***

Subsequent to December 31, 2009, we sold an additional 8,940,225 common shares through Wm Smith for aggregate gross proceeds of \$6.4 million. Total offering expenses related to these sales were \$0.2 million.

### **Forward-Looking Information and Cautionary Factors That May Affect Future Results**

Certain statements contained herein related to the sufficiency of our cash resources and our efforts to enter into a collaborative arrangement with respect to XOMA 052, as well as other statements related to current plans for product development and existing and potential collaborative and licensing relationships, or that otherwise relate to future periods, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based on assumptions that may not prove accurate. Actual results could differ materially from those anticipated due to certain risks inherent in the biotechnology industry and for companies engaged in the development of new products in a regulated market. Among other things, the period for which our cash resources are sufficient could be shortened if expenditures are made earlier or in larger amounts than anticipated or are unanticipated, if anticipated revenue or cost sharing arrangements do not materialize, or if funds are not otherwise available on acceptable terms; and, we may not be able to enter into a collaborative arrangement with respect to XOMA 052 on acceptable terms within the timeframes anticipated or at all. These and other risks, including those related to inability to comply with NASDAQ's continued listing requirements; the generally unstable nature of current economic conditions; the results of discovery research and preclinical testing; the timing or results of pending and future clinical trials (including the design and progress of clinical trials; safety and efficacy of the products being tested; action, inaction or delay by the FDA, European or other regulators or their advisory bodies; and analysis or interpretation by, or submission to, these entities or others of scientific data); changes in the status of existing collaborative relationships; the ability of collaborators and other partners to meet their obligations; our ability to meet the demand of the United States government agency with which we have entered our government contracts; competition; market demands for products; scale-up and marketing capabilities; availability of additional licensing or collaboration opportunities; international operations; share price volatility; our financing needs and opportunities; uncertainties regarding the status of biotechnology patents; uncertainties as to the costs of protecting intellectual property; and risks associated with our status as a Bermuda company, are described in more detail in *Item 1A: Risk Factors*.

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### **Item 7A. Quantitative and Qualitative Disclosures about Market Risk**

#### **Interest Rate Risk**

Our exposure to market rate risk for changes in interest rates relates primarily to our investment portfolio and our loan facility. By policy, we make our investments in high quality debt securities, limit the amount of credit exposure to any one issuer and limit duration by restricting the term of the instrument. We generally hold investments to maturity, with a weighted average portfolio period of less than twelve months. However, if the need arose to liquidate such securities before maturity, we may experience losses on liquidation. We do not invest in derivative financial instruments.

We hold interest-bearing instruments that are classified as cash, cash equivalents and short-term investments. Fluctuations in interest rates can affect the principal values and yields of fixed income investments. If interest rates in the general economy were to rise rapidly in a short period of time, our fixed income investments could lose value.

The following table presents the amounts and related weighted average interest rates of our cash and investments at December 31, 2009 and 2008 (in thousands, except interest rate):

	<u>Maturity</u>	<u>Carrying Amount (in thousands)</u>	<u>Fair Value (in thousands)</u>	<u>Weighted Average Interest Rate</u>
December 31, 2009				
Cash and cash equivalents	Daily to 90 days	\$ 23,909	\$ 23,909	0.38%
December 31, 2008				
Cash and cash equivalents	Daily to 90 days	\$ 9,513	\$ 9,513	2.67%
Short-term investments	91 days to less than 12 months	1,301	1,299	4.64%

As of December 31, 2009, we have an outstanding principal balance on our note with Novartis of \$13.3 million, which is due in 2015. The interest rate on this note is charged at a rate of USD six-month LIBOR plus 2%, which was 2.44% at December 31, 2009. No further borrowing is available under this facility.

The variable interest rate related to our long-term debt instrument is based on LIBOR. We estimate that a hypothetical 100 basis point change in interest rates could increase or decrease our interest expense by approximately \$0.1 million on an annualized basis.

### **Item 8. Financial Statements and Supplementary Data**

The following consolidated financial statements of the registrant, related notes and report of independent registered public accounting firm are set forth beginning on page F-1 of this report.

<a href="#">Report of Independent Registered Public Accounting Firm</a>	F-2
<a href="#">Consolidated Balance Sheets</a>	F-3
<a href="#">Consolidated Statements of Operations</a>	F-4
<a href="#">Consolidated Statements of Shareholders' Equity (Net Capital Deficiency)</a>	F-5
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### **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

Not applicable.

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### **Item 9A. Controls and Procedures**

Under the supervision and with the participation of our management, including our Chairman, Chief Executive Officer and President and our Vice President, Finance and Chief Financial Officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Our disclosure controls and procedures are intended to ensure that the information we are required to disclose in the reports that we file or submit under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (ii) accumulated and communicated to our management, including the Chairman, Chief Executive Officer and President and Vice President, Finance and Chief Financial Officer, as the principal executive and financial officers, respectively, to allow timely decisions regarding required disclosures. Based on this evaluation, our Chairman, Chief Executive Officer and President and our Vice President, Finance and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

We continue to enhance internal financial controls and staffing consistent with the requirements of the Sarbanes-Oxley Act of 2002. Apart from this, there were no changes in our internal controls over financial reporting during 2009 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial accounting.

#### ***Management's Report on Internal Control over Financial Reporting***

Management, including our Chairman, Chief Executive Officer and President and our Vice President, Finance and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting (as such term is defined in Exchange Act Rules 13a-159f). The Company's internal control system was designed to provide reasonable assurance to the Company's management and board of directors regarding the preparation and fair presentation of published financial statements in accordance with accounting principles generally accepted in the United States.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2009. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control—Integrated Framework*. Based on our assessment we believe that, as of December 31, 2009, our internal control over financial reporting is effective based on those criteria.

The Company's internal control over financial reporting as of December 31, 2009, has been audited by Ernst & Young, LLP, the independent registered public accounting firm who also audited the Company's consolidated financial statements. Ernst & Young's attestation report on the Company's internal control over financial reporting follows.

#### **Changes in Internal Control over Financial Reporting**

Our management, including our Chairman, Chief Executive Officer and President and our Vice President, Finance and Chief Financial Officer, has evaluated any changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2009, and has concluded that there was no change during such quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**The Board of Directors and Shareholders of XOMA Ltd.:**

We have audited XOMA Ltd.'s internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). XOMA Ltd.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, XOMA Ltd. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the COSO criteria

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of XOMA Ltd. as of December 31, 2009 and 2008 and the related consolidated statements of operations, shareholders' equity (net capital deficiency) and cash flows for each of the three years in the period ended December 31, 2009, and our report dated March 11, 2010 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Francisco, California  
March 11, 2010

**Item 9B. Other Information**

None.

**PART III**

**Item 10. Directors, Executive Officers, Corporate Governance**

Certain information regarding our executive officers required by this Item is set forth as a Supplementary Item at the end of Part I of this Form 10-K (pursuant to Instruction 3 to Item 401(b) of Regulation S-K). The Company's Code of Ethics applies to all employees, officers and directors including the Chairman, Chief Executive Officer and President, and the Vice President, Finance and Chief Financial Officer and Chief Accounting Officer, and is posted on the Company's website at [www.xoma.com](http://www.xoma.com). Other information required by this Item will be included in the Company's proxy statement for the 2010 Annual General Meeting of Shareholders, under the sections labeled "*Item 1—Election of Directors*" and "*Compliance with Section 16(a) of the Securities Exchange Act of 1934*"; and is incorporated herein by reference.

**Item 11. Executive Compensation**

Information required by this Item will be included in the sections labeled "*Compensation of Executive Officers*", "*Summary Compensation Table*", "*Grants of Plan-Based Awards*", "*Outstanding Equity Awards as of December 31, 2009*", "*Option Exercises and Shares Vested*", "*Pension Benefits*", "*Non-Qualified Deferred Compensation*" and "*Compensation of Directors*" appearing in our proxy statement for the 2010 Annual General Meeting of Shareholders, and is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters**

Information required by this Item will be included in the sections labeled "*Share Ownership*" and "*Equity Compensation Plan Information*" appearing in our proxy statement for the 2010 Annual General Meeting of Shareholders, and is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions, and Director Independence**

Information required by this Item will be included in the section labeled "*Transactions with Related Persons*" appearing in our proxy statement for the 2010 Annual General Meeting of Shareholders, and is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services**

Information required by this Item will be included in the section labeled "*Item 2—Appointment of Independent Registered Public Accounting Firm*" appearing in our proxy statement for the 2010 Annual General Meeting of Shareholders, and is incorporated herein by reference.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

- (a) The following documents are included as part of this Annual Report on Form 10-K:
- (1) Financial Statements:  
All financial statements of the registrant referred to in Item 8 of this Report on Form 10-K.
  - (2) Financial Statement Schedules:  
All financial statements schedules have been omitted because the required information is included in the consolidated financial statements or the notes thereto or is not applicable or required.
  - (3) Exhibits:  
See “Index to Exhibits” on page i of this report.



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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**The Board of Directors and Shareholders of XOMA Ltd.:**

We have audited the accompanying consolidated balance sheets of XOMA Ltd. as of December 31, 2009 and 2008, and the related consolidated statements of operations, shareholders' equity (net capital deficiency), and cash flows for each of the three years in the period ended December 31, 2009. These consolidated financial statements are the responsibility of XOMA Ltd.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of XOMA Ltd. at December 31, 2009 and 2008, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), XOMA Ltd.'s internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 11, 2010 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Francisco, California  
March 11, 2010

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**XOMA Ltd.**  
**CONSOLIDATED BALANCE SHEETS**  
**(in thousands, except share and per share amounts)**

	December 31,	
	2009	2008
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 23,909	\$ 9,513
Short-term investments	—	1,299
Restricted cash	—	9,545
Trade and other receivables, net	7,231	16,686
Prepaid expenses and other current assets	1,012	1,296
Debt issuance costs	—	365
Total current assets	<u>32,152</u>	<u>38,704</u>
Property and equipment, net	20,270	26,843
Debt issuance costs—long-term	—	1,224
Other assets	402	402
Total assets	<u>\$ 52,824</u>	<u>\$ 67,173</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b> <b>(NET CAPITAL DEFICIENCY)</b>		
Current liabilities:		
Accounts payable	\$ 2,942	\$ 9,977
Accrued liabilities	8,629	4,438
Accrued interest	10	1,588
Deferred revenue	2,114	9,105
Warrant liability	4,760	—
Other current liabilities	223	1,884
Total current liabilities	<u>18,678</u>	<u>26,992</u>
Deferred revenue—long-term	2,894	8,108
Interest bearing obligation—long-term	13,341	63,274
Other long-term liabilities	385	200
Total liabilities	<u>35,298</u>	<u>98,574</u>
Commitments and contingencies (Note 11)		
Shareholders' equity (net capital deficiency):		
Preference shares, \$0.05 par value, 1,000,000 shares authorized		
Series A, 210,000 designated, no shares issued and outstanding at December 31, 2009 and 2008	—	—
Series B, 8,000 designated, 2,959 shares issued and outstanding at December 31, 2009 and 2008 (aggregate liquidation preference of \$29.6 million)	1	1
Common shares, \$0.0005 par value, 400,000,000 shares authorized, 203,042,194 and 140,467,529 shares outstanding at December 31, 2009 and 2008, respectively	101	70
Additional paid-in capital	801,978	753,634
Accumulated comprehensive loss	—	(2)
Accumulated deficit	<u>(784,554)</u>	<u>(785,104)</u>
Total shareholders' equity (net capital deficiency)	<u>17,526</u>	<u>(31,401)</u>
Total liabilities and shareholders' equity (net capital deficiency)	<u>\$ 52,824</u>	<u>\$ 67,173</u>

*The accompanying notes are an integral part of these consolidated financial statements.*

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**XOMA Ltd.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(in thousands, except per share amounts)**

	Year Ended December 31,		
	2009	2008	2007
Revenues:			
License and collaborative fees	\$ 43,822	\$ 16,366	\$ 36,460
Contract and other revenue	25,492	30,473	31,057
Royalties	29,116	21,148	16,735
Total revenues	<u>98,430</u>	<u>67,987</u>	<u>84,252</u>
Operating expenses:			
Research and development (including contract related of \$15,924, \$20,828, and \$17,032, respectively, for the years ended December 31, 2009, 2008, and 2007)	58,131	82,576	66,215
Selling, general and administrative	23,736	24,145	20,581
Restructuring	3,603	—	—
Total operating expenses	<u>85,470</u>	<u>106,721</u>	<u>86,796</u>
Income (loss) from operations	12,960	(38,734)	(2,544)
Other income (expense):			
Investment and interest income	49	859	1,866
Interest expense	(4,888)	(7,002)	(11,585)
Loss on debt extinguishment	(3,645)	(652)	—
Other income (expense)	1,801	(99)	(63)
Net income (loss) before taxes	6,277	(45,628)	(12,326)
Income tax (expense) benefit	(5,727)	383	—
Net income (loss)	<u>\$ 550</u>	<u>\$ (45,245)</u>	<u>\$ (12,326)</u>
Basic and diluted net income (loss) per common share	<u>\$ —</u>	<u>\$ (0.34)</u>	<u>\$ (0.10)</u>
Shares used in computing basic net income (loss) per common share	<u>164,900</u>	<u>132,928</u>	<u>127,946</u>
Shares used in computing diluted net income (loss) per common share	<u>169,720</u>	<u>132,928</u>	<u>127,946</u>

*The accompanying notes are an integral part of these consolidated financial statements.*

**XOMA Ltd.**  
**CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY**  
**(NET CAPITAL DEFICIENCY)**  
**(in thousands)**

	Preferred Shares		Common Shares		Paid-In Capital	Accumulated Comprehensive Income (Loss)	Accumulated Deficit	Total Shareholders' Equity (Net Capital Deficiency)
	Shares	Amount	Shares	Amount				
Balance, December 31, 2006	3	\$ 1	105,454	\$ 53	\$689,315	\$ (9)	\$ (727,533)	\$ (38,173)
Exercise of share options, contributions to 401(k) and incentive plans	—	—	864	—	1,976	—	—	1,976
Share-based compensation expense under SFAS 123R	—	—	—	—	2,858	—	—	2,858
Conversion of convertible debt	—	—	25,640	13	45,970	—	—	45,983
Comprehensive loss:								
Net loss	—	—	—	—	—	—	(12,326)	(12,326)
Comprehensive loss	—	—	—	—	—	—	—	(12,326)
Balance, December 31, 2007	3	1	131,958	66	740,119	(9)	(739,859)	318
Exercise of share options, contributions to 401(k) and incentive plans	—	—	577	—	1,389	—	—	1,389
Share-based compensation expense under SFAS 123R	—	—	—	—	4,934	—	—	4,934
Sale of shares of common stock	—	—	7,932	4	7,192	—	—	7,196
Comprehensive income (loss):								
Net change in unrealized loss on investments	—	—	—	—	—	7	—	7
Net loss	—	—	—	—	—	—	(45,245)	(45,245)
Comprehensive loss	—	—	—	—	—	—	—	(45,238)
Balance, December 31, 2008	3	1	140,467	70	753,634	(2)	(785,104)	(31,401)
Exercise of share options, contributions to 401(k) and incentive plans	—	—	2,029	1	1,358	—	—	1,359
Share-based compensation expense under SFAS 123R	—	—	—	—	4,395	—	—	4,395
Sale of shares of common stock	—	—	60,546	30	42,591	—	—	42,621
Comprehensive income:								
Net change in unrealized loss on investments	—	—	—	—	—	2	—	2
Net income	—	—	—	—	—	—	550	550
Comprehensive income	—	—	—	—	—	—	—	552
Balance, December 31, 2009	<u>3</u>	<u>\$ 1</u>	<u>203,042</u>	<u>\$ 101</u>	<u>\$801,978</u>	<u>\$ —</u>	<u>\$ (784,554)</u>	<u>\$ 17,526</u>

*The accompanying notes are an integral part of these consolidated financial statements.*

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**XOMA Ltd.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)

	Year Ended December 31,		
	2009	2008	2007
<b>Cash flows from operating activities:</b>			
Net income (loss)	\$ 550	\$(45,245)	\$(12,326)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	6,831	6,721	6,155
Common shares contribution to 401(k) and management incentive plans	1,198	1,008	1,321
Share-based compensation expense	4,395	4,934	2,858
Accrued interest on convertible notes and interest bearing obligations	(1,116)	1,921	408
Revaluation of embedded derivative	—	—	6,101
Interest paid on conversion of convertible debt	—	—	(5,172)
Revaluation of warrant liability	(1,781)	—	—
Amortization of discount, premium and debt issuance costs of debt and convertible debt	487	726	584
(Gain) loss on disposal/retirement of property and equipment	(15)	99	146
Loss on debt extinguishment	3,645	652	—
Other non-cash adjustments	27	—	(12)
Changes in assets and liabilities:			
Receivables	9,455	(4,551)	(52)
Prepaid expenses and other assets	284	(183)	3
Accounts payable and accrued liabilities	(2,844)	(290)	3,433
Deferred revenue	(12,205)	(851)	1,096
Other liabilities	(1,476)	2,084	—
Net cash provided by (used in) operating activities	<u>7,435</u>	<u>(32,975)</u>	<u>4,543</u>
<b>Cash flows from investing activities:</b>			
Proceeds from sales of investments	—	9,875	31,480
Proceeds from maturities of investments	1,300	8,099	3,840
Purchase of investments	—	(3,199)	(32,994)
Transfer of restricted cash	9,545	(3,526)	(1,689)
Purchase of property and equipment	(270)	(8,060)	(9,469)
Net cash provided by (used in) investing activities	<u>10,575</u>	<u>3,189</u>	<u>(8,832)</u>
<b>Cash flows from financing activities:</b>			
Proceeds from issuance of long-term debt	—	55,000	2,840
Principal payments of debt	(50,394)	(45,779)	(4,707)
Payment of prepayment premium on repayment of short-term debt	(2,543)	—	—
Proceeds from issuance of common shares	49,323	7,578	654
Net cash (used in) provided by financing activities	<u>(3,614)</u>	<u>16,799</u>	<u>(1,213)</u>
Net increase (decrease) in cash and cash equivalents	14,396	(12,987)	(5,502)
Cash and cash equivalents at the beginning of the period	9,513	22,500	28,002
Cash and cash equivalents at the end of the period	<u>\$ 23,909</u>	<u>\$ 9,513</u>	<u>\$ 22,500</u>
<b>Supplemental Cash Flow Information:</b>			
Cash paid during the year for:			
Interest	\$ 5,510	\$ 4,354	\$ 3,077
Income taxes	6	—	—
Non-cash investing and financing activities:			
Fair value of warrant liability	\$ 4,760	\$ —	\$ —
Interest added to principal balance on Novartis note	462	1,183	1,323
Debt reduction on Novartis note	—	7,500	—
Conversion of convertible debt to equity	—	—	44,521

*The accompanying notes are an integral part of these consolidated financial statements.*

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**1. Description of Business**

XOMA Ltd. (“XOMA” or the “Company”), a Bermuda company, is a biopharmaceutical company focused on the discovery, development and manufacture of therapeutic antibodies designed to treat inflammatory, autoimmune, infectious and oncological diseases. The Company’s products are presently in various stages of development and most are subject to regulatory approval before they can be commercially launched.

**2. Basis of Presentation and Significant Accounting Policies**

**Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

**Liquidity and Financial Condition**

The Company has incurred significant operating losses and negative cash flows from operations since its inception. As of December 31, 2009, the Company had cash and cash equivalents of \$23.9 million and working capital of \$13.5 million. Based on cash and cash equivalents on hand at December 31, 2009 and anticipated spending levels, revenue from collaborations including a XOMA 052 corporate partnership, licensing transactions or biodefense contracts and other sources of funding the Company believes to be available, the Company estimates that it has sufficient cash resources to meet its anticipated net cash needs through the next twelve months.

The Company may be required to raise additional funds through public or private financings, strategic relationships, or other arrangements. The Company cannot assure that the funding, if needed, will be available on terms attractive to it, or at all. Furthermore, any additional equity financings may be dilutive to shareholders and debt financing, if available, may involve restrictive covenants. The Company’s failure to raise capital as and when needed could have a negative impact on its financial condition and its ability to pursue business strategies. If adequate funds are not available, the Company has developed contingency plans that may require the Company to delay, reduce the scope of, or eliminate one or more of its development programs. In addition, the Company may be required to further reduce personnel-related costs and other discretionary expenditures that are within the Company’s control.

The accompanying financial statements have been prepared assuming the Company will continue to operate as a going concern, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. The consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from uncertainty related to the Company’s ability to continue as a going concern.

**Use of Estimates and Reclassifications**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosures. On an on-going basis, management evaluates its estimates, including those related to revenue recognition, research and development expense, long-lived assets, warrant liabilities and share-based compensation. The Company bases its estimates on historical experience and on various other market-specific and other relevant assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ significantly from these estimates.

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

For example, in the third quarter of 2008, the Company recorded a change in accounting estimate as a result of an audit by the National Institutes of Health (“NIH”) of the Company’s 2007 actual data, from which the NIH developed billing rates for the period from January 2007 to June 2009 to be used for all of the Company’s contracts with the National Institute of Allergy and Infectious Diseases (“NIAID”), a part of the NIH, including Contract No. HHSN26620060008C/N01-A1-60008 (“NIAID 2”). While the audited NIH rates are considered final for 2007 billings, these NIH rates are considered provisional for the period from January of 2008 to June of 2009 and thus are subject to future audits at the discretion of NIAID’s contracting office. In September of 2008, the Company retroactively applied these NIH rates to the invoices from 2007 through the third quarter of 2008 resulting in an adjustment to decrease revenue by \$2.7 million. The adjustment increased the Company’s loss from operations and net loss for the year ended December 31, 2008 by \$2.7 million. The adjustment also increased basic and diluted net loss per common share by \$0.02 for the year ended December 31, 2008.

Certain reclassifications of prior period amounts have been made to the financial statements and accompanying notes to conform to the current period presentation. Prior period disclosures have been expanded in the consolidated statements of operations to reclassify the loss recognized on debt extinguishment in the second quarter of 2008 from interest expense to a separate line item. In addition, the interest expense disclosures in *Note 7: Long-Term Debt and Other Arrangements* have also been revised to conform to the current period presentation. This reclassification had no impact on the Company’s previously reported net earnings (losses), financial position or cash flows.

**Recent Accounting Pronouncements**

In June of 2009, the Financial Accounting Standards Board (“FASB”) established the FASB Accounting Standards Codification (the “ASC”) as the source of authoritative accounting principles recognized by the FASB. The FASB will issue new standards in the form of Accounting Standards Updates (“ASU”). The ASC is effective for financial statements issued for interim and annual periods ending after September 15, 2009 and therefore was effective for the Company in the third quarter of 2009. The issuance of the ASC does not change U.S. generally accepted accounting principles (“GAAP”) and therefore the adoption of the ASC only affects the specific references to GAAP literature in the notes to consolidated financial statements.

Accounting Standards Codification Topic 855, *Subsequent Events* (“ASC 855”) establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. In particular, ASC 855 sets forth the period after the balance sheet date during which the Company should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. The new provisions of ASC 855 were effective for interim financial reporting periods ending after June 15, 2009 and did not have a material effect on the Company’s financial statements. ASC 855 was subsequently amended by Accounting Standards Update No. 2010-09 (“ASU 2010-09”) which removed the requirement that an entity disclose the date through which it evaluated subsequent events in the financial statements. ASU 2010-09 was effective upon issuance in February of 2010 and did not have a material effect on the Company’s financial statements.

Accounting Standards Codification Topic 320, *Investments- Debt and Equity Securities* (“ASC 320”) contains an amendment to make previous guidance regarding other-than-temporary impairments more operational and to improve the presentation of other-than-temporary impairments in the financial statements. This amendment replaces the existing requirement that management assert it has both the intent and ability to hold an impaired debt security until recovery with a requirement that the Company assert it does not have the intent to sell the security and it is more likely than not it will not have to sell the security before recovery of its

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

cost basis. ASC 320 requires increased and more frequent disclosures regarding expected cash flows, credit losses, and an aging of securities with unrealized losses. The amended provisions of ASC 320 were effective for interim financial reporting periods ending after April 1, 2009 and did not have a material effect on the Company's financial statements.

Accounting Standards Codification Topic 808, *Collaborative Arrangements* ("ASC 808") defines collaborative arrangements and establishes reporting requirements for transactions between participants and third parties in a collaborative arrangement. ASC 808 prohibits companies from applying the equity method of accounting to activities performed outside a separate legal entity by a virtual joint venture. Instead, revenue and costs incurred with third parties in connection with the collaborative arrangement should be presented gross or net by the collaborators based on the criteria in Accounting Standards Codification Topic 605, *Revenue Recognition* ("ASC 605"), and other applicable accounting literature. The new provisions of ASC 808 should be applied to collaborative arrangements in existence at the date of adoption using a modified retrospective method that requires reclassification in all periods presented for those arrangements still in effect at the transition date, unless that application is impracticable. Effective January 1, 2009 the Company adopted the new provisions of ASC 808, which did not have a material effect on the Company's financial statements. As a result of the restructuring in November of 2008 of the Company's collaboration agreement with Novartis AG ("Novartis") as further discussed in *Note 4: Licensing, Collaborative and Other Arrangements*, this collaboration agreement is no longer within the scope of ASC 808. As of December 31, 2009, the Company does not have any collaboration agreements that fall under the scope of ASC 808.

Accounting Standards Codification Topic 815, *Derivatives and Hedging* ("ASC 815") clarifies how to determine whether certain instruments or features are indexed to an entity's own stock. This provision of ASC 815 applies to any free standing financial instrument or embedded feature that has all the characteristics of a derivative, as defined in ASC 815. Effective January 1, 2009, the Company adopted the relevant provisions of ASC 815. Refer to the *Significant Accounting Policies* section below for the effect this adoption had on the Company's financial statements.

Accounting Standards Codification Topic 820, *Fair Value Measurements and Disclosures* ("ASC 820") defines fair value and establishes a framework for measuring the fair value of financial assets and liabilities. Effective January 1, 2009, the Company adopted the provisions of ASC 820, as it relates to non-financial assets and non-financial liabilities, which did not have a material effect on the Company's financial statements.

Accounting Standards Update No. 2009-13, Revenue Recognition Topic 605: *Multiple Deliverable Revenue Arrangements—A Consensus of the FASB Emerging Issues Task Force* provides application guidance on whether multiple deliverables exist, how the deliverables should be separated and how the consideration should be allocated to one or more units of accounting. This update establishes a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence, if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific or third-party evidence is available. The Company will adopt this guidance from January 1, 2011. The Company is assessing the impact of this guidance on its consolidated results of operations and financial condition.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

**Significant Accounting Policies**

The following policies are critical to an understanding of the Company's financial condition and results of operations because they require it to make estimates, assumptions and judgments about matters that are inherently uncertain.

***Revenue Recognition***

Revenue is recognized when the four basic criteria of revenue recognition are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the fee is fixed and determinable; and (4) collectibility is reasonably assured. The determination of criteria (2) is based on management's judgments regarding whether a continuing performance obligation exists. The determination of criteria (3) and (4) are based on management's judgments regarding the nature of the fee charged for products or services delivered and the collectibility of those fees. Allowances are established for estimated uncollectible amounts, if any.

The Company recognizes revenue from its license and collaboration arrangements, contract services and royalties. Revenue arrangements with multiple elements are divided into separate units of accounting if certain criteria are met, including whether the delivered element has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. The consideration received is allocated among the separate units based on their respective fair values and the applicable revenue recognition criteria are applied to each of the separate units. Advance payments received in excess of amounts earned are classified as deferred revenue until earned.

***License and Collaborative Fees***

Revenue from non-refundable license, technology access or other payments under license and collaborative agreements where the Company has a continuing obligation to perform is recognized as revenue over the expected period of the continuing performance obligation. The Company estimates the performance period at the inception of the arrangement and reevaluates it each reporting period. This reevaluation may shorten or lengthen the period over which the remaining revenue is recognized. Changes to these estimates are recorded on a prospective basis.

Milestone payments under collaborative and other arrangements are recognized as revenue upon completion of the milestone event, once confirmation is received from the third party and collectibility is reasonably assured. This represents the culmination of the earnings process because the Company has no future performance obligations related to the payment. Milestone payments that require a continuing performance obligation on the part of the Company are recognized over the expected period of the continuing performance obligation. Amounts received in advance are recorded as deferred revenue until the related milestone is completed.

***Contract Revenue***

Contract revenue for research and development involves the Company providing research and development and manufacturing services to collaborative partners, biodefense contractors or others. Revenue for certain contracts is accounted for by a proportional performance, or output-based, method where performance is based on estimated progress toward elements defined in the contract. The amount of contract revenue and related costs recognized in each accounting period are based on management's estimates of the proportional performance during the period. Adjustments to estimates based on actual performance are recognized on a prospective basis and do not result in reversal of revenue should the estimate to complete be extended.

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Up-front fees are recognized ratably over the expected benefit period under the arrangement. Given the uncertainties of research and development collaborations, significant judgment is required to determine the duration of the arrangement.

***Royalty Revenue***

Royalty revenue and royalty receivables are generally recorded in the periods these royalties are earned, in advance of collection. The royalty revenue and receivables in these instances is based upon communication with collaborative partners or licensees, historical information and forecasted sales trends.

***Research and Development Expenses***

The Company expenses research and development costs as incurred. Research and development expenses consist of direct costs such as salaries and related personnel costs and material and supply costs, and research-related allocated overhead costs, such as facilities costs. In addition, research and development expenses include costs related to clinical trials. Expenses resulting from clinical trials are recorded when incurred based in part on estimates as to the status of the various trials. From time to time, research and development expenses may include up-front fees and milestones paid to collaborative partners for the purchase of rights to in-process research and development. Such amounts are expensed as incurred.

***Share-Based Compensation***

The Company grants qualified and non-qualified share options, shares and other share-related awards under various plans to directors, officers, employees and other individuals. Share options are granted at exercise prices of not less than the fair market value of the Company's common shares on the date of grant. Generally, share options granted to employees fully vest four years from the grant date and expire ten years from the date of the grant or three months from the date of termination of employment (longer in case of death or certain retirements). However, certain options granted to employees vest monthly or immediately, certain options granted to directors vest monthly over one year or three years and certain options may fully vest upon a change of control of the Company or may accelerate based on performance-driven measures. Additionally, the Company has an Employee Share Purchase Plan ("ESPP") that allows employees to purchase Company shares at a purchase price equal to 95% of the closing price on the exercise date.

The Company recognizes compensation expense for all share-based payment awards made to the Company's employees and directors based on estimated fair values. The valuation of share-based compensation awards is determined at the date of grant using the Black-Scholes option pricing model. This model requires inputs such as the expected term of the option, expected volatility and risk-free interest rate. Further, the forfeiture rate also impacts the amount of aggregate compensation. To establish an estimate of expected term, the Company considers the vesting period and contractual period of the award and its historical experience of share option exercises, post-vesting cancellations and volatility. To establish an estimate of forfeiture rate, the Company considers its historical experience of option forfeitures and terminations. The risk-free rate is based on the yield available on United States Treasury zero-coupon issues.

Share-based compensation expense is recognized ratably over the requisite service period. If options are granted that include a performance condition, the Company estimates the probability of the performance condition being achieved on a quarterly basis. If it is determined that it is probable the performance criteria will be achieved, the Company estimates an implicit service period from grant date to the most likely date of achievement of the performance criteria and records share-based compensation expense ratably over this implicit service period.

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

***Cash and Cash Equivalents and Short-term Investments***

The Company considers all highly liquid debt instruments with maturities of three months or less at the time the Company acquires them to be cash equivalents.

Short-term investments include debt securities classified as available-for-sale. Available-for-sale securities are stated at fair value, with unrealized gains and losses, net of tax, if any, reported in other comprehensive income (loss). The estimate of fair value is based on publicly available market information. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are also included in investment and other income. The Company reviews its instruments for other-than-temporary impairment whenever the value of the instrument is less than the amortized cost. The cost of investments sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in investment and other income.

***Property and Equipment and Long-Lived Assets***

Property and equipment is stated at cost less depreciation. Equipment depreciation is calculated using the straight-line method over the estimated useful lives of the assets (three to seven years). Leasehold improvements, buildings and building improvements are amortized and depreciated using the straight-line method over the shorter of the lease terms or the useful lives (one to fifteen years).

The Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets in the future are less than the carrying amounts of those assets.

***Warrant Liabilities***

In the second quarter of 2009, the Company issued warrants to purchase XOMA's common shares in connection with two separate registered direct offerings. Refer to *Note 10: Share Capital* for additional disclosure relating to these two transactions. The warrants issued included a provision allowing for an adjustment of the exercise price and number of warrant shares. This adjustment would occur if the Company issued or sold certain common shares in the future for a price per share less than the exercise price of the warrants in effect immediately prior to such issuance or sale. Due to this adjustment provision, the warrants did not meet the criteria set forth by ASC 815 and therefore were not considered indexed to the Company's own stock.

The Company recorded these warrants as a liability at fair value, which was estimated at the issuance dates using the Monte Carlo Simulation Model ("Simulation Model"). The Simulation Model requires inputs such as the expected term of the warrants, share price volatility, risk-free interest rate and the likelihood and timing of future equity financings. These assumptions are reviewed on a quarterly basis and changes in the estimated fair value of the warrants are recognized in other income (expense).

***Income Taxes***

The application of income tax law and regulations is inherently complex. Interpretations and guidance surrounding income tax laws and regulations change over time. As such, changes in the Company's subjective assumptions and judgments can materially affect amounts recognized in the consolidated financial statements.

The Company accounts for uncertain tax positions in accordance with Accounting Standards Codification Topic 740, *Income Taxes* ("ASC 740"). ASC 740 provides for the recognition of deferred tax assets if realization

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

of such assets is more likely than not. Based upon the weight of available evidence, which includes the Company's historical operating performance and carry-back potential, the Company has determined that total deferred tax assets should be fully offset by a valuation allowance.

*Net Income (Loss) per Common Share*

Basic and diluted net income (loss) per common share is based on the weighted average number of common shares outstanding during the period. Diluted net income (loss) per common share is based on the weighted average number of common shares and other dilutive securities outstanding during the period, provided that including these dilutive securities does not increase the net income (loss) per share.

Potentially dilutive securities are excluded from the calculation of earnings per share if their inclusion is anti-dilutive. The following table shows the total outstanding securities considered anti-dilutive and therefore excluded from the computation of diluted net income (loss) per share (in thousands):

	December 31,		
	2009	2008	2007
Options for common shares	17,349	19,810	11,108
Convertible preference shares	—	3,818	3,818
Warrants for common shares (1)	11,100	—	125
Total	<u>28,449</u>	<u>23,628</u>	<u>15,051</u>

(1) 2007 warrants expired in July of 2008

For the year ended December 31, 2009, the following is a reconciliation of the numerators and denominators of the basic and diluted net income per share (in thousands):

	Year ended December 31, 2009
<b>Numerator</b>	
Net income used for basic and diluted net income per share	\$ 550
<b>Denominator</b>	
Weighted average shares outstanding used for basic net income per share	164,900
Effect of dilutive share options	1,002
Effect of convertible preference shares	3,818
Weighted average shares outstanding and dilutive securities used for diluted net income per share	<u>169,720</u>

For the years ended December 31, 2008 and 2007, all outstanding common stock equivalents were considered anti-dilutive and therefore the calculations of basic and diluted net loss per share are the same.

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

3. Consolidated Financial Statement Detail

*Cash and Cash Equivalents*

At December 31, 2009 and 2008, cash and cash equivalents consisted of overnight deposits and money market funds and repurchase agreements with maturities of less than 90 days at the date of purchase. Cash and cash equivalent balances were recorded at fair value as follows as of December 31, 2009 and 2008 (in thousands):

	December 31, 2009			
	Cost Basis	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	\$ 3,065	\$ —	\$ —	\$ 3,065
Cash equivalents	20,844	—	—	20,844
Total cash and cash equivalents	<u>\$23,909</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 23,909</u>

	December 31, 2008			
	Cost Basis	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Cash	\$ 553	\$ —	\$ —	\$ 553
Cash equivalents	8,960	—	—	8,960
Total cash and cash equivalents	<u>\$ 9,513</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 9,513</u>

*Short-term Investments*

At December 31, 2009, the Company had no short-term investments. At December 31, 2008, all short-term investments had maturities of less than one year. Short-term investments by security type at December 31, 2008 were as follows (in thousands):

	December 31, 2008			
	Cost Basis	Unrealized Gains	Unrealized Losses	Estimated Fair Value
Corporate notes and bonds	\$1,301	\$ —	\$ (2)	\$ 1,299
Total Short-term Investments	<u>\$1,301</u>	<u>\$ —</u>	<u>\$ (2)</u>	<u>\$ 1,299</u>

During the year ended December 31, 2008, the Company recognized \$4,000 in realized gains on short-term investments, as compared with no realized gains on short-term investments in 2009 or 2007. During the years ended December 31, 2009, 2008 and 2007, there were no realized losses on short-term investments.

*Restricted Cash*

At December 31, 2009, the Company had no restricted cash. At December 31, 2008, the Company had a restricted cash balance of \$9.5 million, which included \$8.6 million in a custodial account related to the Company's term loan with Goldman Sachs Specialty Lending Holdings, Inc. ("Goldman Sachs") and \$0.9 million in an irrevocable letter of credit ("LOC") arrangement. These amounts were invested in money market funds and a certificate of deposit, respectively.

Under the terms of the Company's loan agreement with Goldman Sachs, the Company maintained a custodial account, which was closed in the third quarter of 2009 upon full repayment of the loan, for the deposit

## XOMA Ltd.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

of royalty revenue in addition to a standing reserve of the next semi-annual interest payment due on the loan. This cash account and the interest earned thereon was used solely for the payment of the semi-annual interest amounts due on each April 1 and October 1 that the loan was outstanding and, at that time, amounts in excess of the interest reserve requirement were used to pay down principal or distributed back to the Company, at the discretion of the lenders. Refer to *Note 7: Long-Term Debt and Other Arrangements* for further disclosure of the Goldman Sachs term loan facility.

In April of 2008, the Company entered into an LOC arrangement in favor of an insurance company agent that was certified to draw funds on the LOC not to exceed \$942,000. The LOC was intended to cover any potential liability, loss, or costs incurred by the agent under any bonds or undertakings for the purpose of clearing manufacturing materials through U.S. Customs and Border Protection. The LOC expired, if not renewed, in one year, and required the Company to record the LOC balance as restricted cash on the consolidated balance sheet. These funds were released to the Company in the first quarter of 2009.

**Receivables**

Receivables consisted of the following at December 31, 2009 and 2008 (in thousands):

	December 31,	
	2009	2008
Trade receivables, net	\$ 6,391	\$ 16,274
Other receivables	840	412
Total	<u>\$ 7,231</u>	<u>\$ 16,686</u>

**Property and Equipment**

Property and equipment consisted of the following at December 31, 2009 and 2008 (in thousands):

	December 31,	
	2009	2008
Furniture and equipment	\$ 31,429	\$ 36,592
Buildings, leasehold and building improvements	21,463	22,355
Construction-in-progress	196	1,108
Land	310	310
	53,398	60,365
Less: Accumulated depreciation and amortization	(33,128)	(33,522)
Property and equipment, net	<u>\$ 20,270</u>	<u>\$ 26,843</u>

Depreciation and amortization expense was \$6.8 million, \$6.7 million and \$6.2 million for the years ended December 31, 2009, 2008 and 2007, respectively.

**XOMA Ltd.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Accrued Liabilities**

Accrued liabilities consisted of the following at December 31, 2009 and 2008 (in thousands):

	December 31,	
	2009	2008
Accrued management incentive compensation	\$ 3,681	\$ —
Accrued restructuring costs	155	—
Accrued payroll and other benefits	2,691	2,776
Accrued professional fees	767	514
Accrued clinical trial costs	609	438
Other	726	710
Total	<u>\$ 8,629</u>	<u>\$ 4,438</u>

**Deferred Revenue**

In 2009, the Company deferred \$16.2 million of revenue from five contracts including Takeda Pharmaceutical Company Limited (“Takeda”), Schering-Plough Research Institute, a division of Schering Corporation, now a subsidiary of Merck & Co., Inc. (referred to herein as “Merck/Schering-Plough”) and Novartis AG (“Novartis”) and recognized \$28.4 million in revenue from the five contracts. In 2008, the Company deferred \$17.5 million of revenue from five contracts including Merck/Schering-Plough, Takeda and Novartis and recognized \$18.4 million of revenue from the five contracts.

The following table shows the activity in deferred revenue for the years ended December 31, 2009 and 2008 (in thousands):

	Year ended December 31,	
	2009	2008
Beginning deferred revenue	\$ 17,213	\$ 18,064
Revenue deferred	16,220	17,515
Revenue recognized	(28,425)	(18,366)
Ending deferred revenue	<u>\$ 5,008</u>	<u>\$ 17,213</u>

Of the \$5.0 million balance in deferred revenue at December 31, 2009, \$2.1 million is expected to be earned over the next year and the remaining \$2.9 million is expected to be earned over the next five years.

**Other Current Liabilities**

Other current liabilities consisted of the following at December 31, 2009 and 2008 (in thousands):

	December 31,	
	2009	2008
Due to government agency	\$223	\$1,551
Other	—	333
Total	<u>\$223</u>	<u>\$1,884</u>

The amount due to government agency at December 31, 2009 and 2008 relates to payments received from the NIAID 2 contract. In 2008, the NIH completed an audit of XOMA’s 2007 actual data and developed billing

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

rates for the period from January of 2007 to June of 2009 to be used for all of the Company's government contracts. As a result, XOMA retroactively applied these NIH rates to the invoices from 2007 through the third quarter of 2008 resulting in an adjustment to decrease revenue by \$2.7 million. Refer to *Note 2: Basis of Presentation and Significant Accounting Policies—Use of Estimates and Reclassifications* above for more detail.

**4. Licensing, Collaborative and Other Arrangements**

*Licensing Agreements*

XOMA has granted over 50 licenses to biotechnology and pharmaceutical companies to use the Company's patented and proprietary technologies relating to bacterial expression of recombinant pharmaceutical products. In exchange, the Company receives license and other fees as well as access to certain of these companies' antibody display libraries, intellectual property and/or services that complement the Company's existing development capabilities and support the Company's own antibody product development pipeline.

Certain of these agreements also provide releases of the licensee companies and their collaborators from claims under the XOMA patents arising from past activities using the companies' respective technologies to the extent they also used XOMA's antibody expression technology. Licensees are generally also allowed to use XOMA's technology in combination with their own technology in future collaborations.

*Pfizer*

In August of 2007, the Company entered into a license agreement with Pfizer Inc. ("Pfizer") for non-exclusive, worldwide rights for XOMA's patented bacterial cell expression technology for research, development and manufacturing of antibody products. Under the terms of the agreement, the Company received a license fee payment of \$30 million in 2007. The Company has no further obligations under the license agreement and accordingly, the \$30 million was recognized as revenue in 2007.

In 2008, the Company received milestone payments of \$0.7 million related to two products, including \$0.5 million for the initiation of a Phase 3 clinical trial, and in 2009, the Company received milestone payments of \$0.4 million related to two additional products. The Company may receive additional milestones, royalties and other fees on future sales of products subject to this license, including products currently in late-stage clinical development. The Company will recognize revenue on milestones when they are achieved and on royalties when the underlying sales occur.

*Collaborative and Other Agreements*

Total research and development expenses related to the Company's collaborative agreements were approximately \$15.9 million, \$24.1 million and \$20.4 million in 2009, 2008 and 2007, respectively.

*Takeda*

In November of 2006, the Company entered into a fully funded collaboration agreement with Takeda for therapeutic monoclonal antibody discovery and development. Under the agreement, Takeda will make up-front, annual maintenance and milestone payments to the Company, fund its research and development and manufacturing activities for preclinical and early clinical studies and pay royalties on sales of products resulting from the collaboration. Takeda will be responsible for clinical trials and commercialization of drugs after an Investigational New Drug Application ("IND") submission and is granted the right to manufacture once the product enters into Phase 2 clinical trials. During the collaboration, the Company will discover therapeutic antibodies against targets selected by Takeda. The Company will recognize revenue on the up-front and annual

**XOMA Ltd.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

payments on a straight-line basis over the expected term of each target antibody discovery, on the research and development and manufacturing services as they are performed on a time and materials basis, on the milestones when they are achieved and on the royalties when the underlying sales occur. In the fourth quarter of 2009, certain discovery and development programs under this collaboration were discontinued following analysis of the research data. This resulted in the recognition of \$2.8 million of the remaining unamortized balance in deferred revenue pertaining to the discontinued programs. In 2009, the Company recognized revenue of \$7.5 million under this agreement, compared with \$4.4 million in 2008 and \$3.1 million in 2007.

In February of 2009, the Company expanded its existing collaboration agreement with Takeda to provide Takeda with access to multiple antibody technologies, including a suite of research and development technologies and integrated information and data management systems. The Company was paid a \$29 million expansion fee, of which \$23.2 million was received in cash in February of 2009 and the remainder was withheld for payment to the Japanese taxing authority. After deducting \$0.9 million in costs related to the agreement, the Company recognized \$28.1 million in revenue in 2009, as the terms of the expansion were fulfilled and no related continuing performance obligations exist. The Company may be entitled to future milestone payments and royalties on product sales.

***Arana***

In September of 2009, the Company entered into an antibody discovery collaboration with Arana Therapeutics Limited, a wholly-owned subsidiary of Cephalon, Inc. (“Arana”), involving multiple proprietary XOMA antibody research and development technologies, including a new antibody phage display library and a suite of integrated information and data management systems. Arana agreed to pay the Company a fee of \$6 million, which was recognized as revenue in 2009 as the terms of the agreement were fulfilled and no related continuing performance obligations exist. In the third quarter of 2009, the Company received \$4 million of the fee in cash and the remaining \$2 million, payable in September of 2010, was included in trade receivables at December 31, 2009. The Company may be entitled to future milestone payments, aggregating up to \$3 million per product, and royalties on product sales.

***Kaketsuken***

In October of 2009, the Company entered into an antibody discovery collaboration with The Chemo-Sero-Therapeutic Research Institute, a Japanese research foundation known as Kaketsuken, involving multiple proprietary XOMA antibody research and development technologies, including a new antibody phage display library and a suite of integrated information and data management systems. Kaketsuken agreed to pay the Company a fee of \$8 million, which was recognized as revenue in 2009 as the terms of the agreement were fulfilled and no related continuing performance obligations exist. In the fourth quarter of 2009, the Company received \$6 million of the fee in cash and the remaining \$2 million, payable in October of 2010, was included in trade receivables at December 31, 2009. The Company may be entitled to future milestone payments, aggregating up to \$0.2 million per product, and royalties on product sales.

***NIAID***

In September of 2008, the Company announced that it had been awarded a \$65 million multiple-year contract funded with federal funds from NIAID, a part of the NIH (Contract No. HHSN272200800028C), to continue development of anti-botulinum antibody product candidates. The contract work is being performed on a cost plus fixed fee basis over a three-year period. The Company is recognizing revenue under the arrangement as the services are performed on a proportional performance basis. In 2009, the Company recognized revenue of \$5.1 million under this contract, compared with \$4.2 million in 2008.

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

In July of 2006, the Company was awarded a \$16.3 million contract to produce monoclonal antibodies for the treatment of botulism to protect United States citizens against the harmful effects of botulinum neurotoxins used in bioterrorism. The contract work is being performed on a cost plus fixed fee basis. The original contract was for a three-year period, however the contract was extended into 2010. The Company is recognizing revenue as the services are performed on a proportional performance basis. This work was substantially complete as of December 31, 2009. In 2008, the NIH completed an audit of XOMA's 2007 actual data and developed billing rates for the period from January of 2007 to June of 2009 to be used for all of the Company's government contracts. As a result, XOMA retroactively applied these NIH rates to the invoices from 2007 through the third quarter of 2008 resulting in an adjustment to decrease revenue by \$2.7 million. Refer to *Note 2: Basis of Presentation and Significant Accounting Policies—Use of Estimates and Reclassifications* above for more detail. As of December 31, 2009, \$0.2 million of the \$2.7 million credit remains to be applied to future services. In 2009, the Company recognized revenue of \$1.6 million under this contract, compared with \$1.3 million in 2008 and \$11.3 million in 2007.

**SRI International**

In the third quarter of 2009, the Company began work on two biodefense subcontract awards from SRI International, including a \$1.7 million award to develop novel antibody drugs against the virus that causes severe acute respiratory syndrome and a \$2.2 million award to develop a novel antibody, known as F10, that has been shown to neutralize group 1 influenza A viruses, including the H1N1 and H5N1 strains. The subcontract awards are funded through NIAID. The Company will recognize revenue under these arrangements as the related research and development costs are incurred. In 2009, the Company recognized revenue of \$0.3 million related to these subcontracts.

**Novartis**

In November of 2008, the Company restructured its product development collaboration with Novartis entered into in 2004 for the development and commercialization of antibody products for the treatment of cancer. Under the restructured agreement, the Company received \$6.2 million in cash and \$7.5 million in the form of debt reduction on its existing loan facility with Novartis. In addition, the Company may, in the future, receive milestones and double-digit royalty rates for certain product programs and options to develop or receive royalties on additional programs. In exchange, Novartis received control over certain programs under the original product development collaboration. The Company recognized revenue on the \$13.7 million consideration received in November of 2008, as the Company had completed the transfer of the full rights to and materials of the collaboration targets now controlled by Novartis.

Under the original product development collaboration, the Company received initial payments of \$10 million in 2004, which were being recognized ratably over five years, the expected term of the agreement, as license and collaborative fees. In February of 2007, the Company announced the parties' mutual exclusivity obligation to conduct antibody discovery, development and commercialization work in oncology had ended. The expiration of this mutual obligation had no impact on the existing collaboration projects which had reached the development stage and the parties continued to collaborate on a non-exclusive basis. The remaining unamortized balance of \$4.3 million of the initial collaboration fee of \$10 million was recognized in 2007 due to the change in estimate from five years to three years. The Company recognized development expenses relating to the collaboration with Novartis of \$4.5 million in 2008 and \$3.8 million in 2007.

A loan facility of up to \$50 million was available to the Company to fund up to 75% of its share of development expenses incurred beginning in 2005. See *Note 7: Long-Term Debt and Other Arrangements* for additional disclosure of the financing arrangement between the Company and Novartis.

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

In December of 2008, the Company entered into a Manufacturing and Technology Transfer Agreement with Novartis, effective July 1, 2008. Under this agreement, XOMA was engaged by Novartis to perform research and development, process development, manufacturing and technology transfer activities with respect to certain product programs under the original product development collaboration. The work performed under this agreement was fully funded by Novartis and completed in the third quarter of 2009. The Company recognized revenue related to this agreement as the research and development and other services were performed on a time and materials basis. In 2009, the Company recognized revenue of \$2.5 million related to this agreement, compared with \$6.6 million in 2008.

***Merck/Schering-Plough***

In May of 2006, the Company entered into a fully funded collaboration agreement with Merck/Schering-Plough for therapeutic monoclonal antibody discovery and development. Under the agreement, Merck/Schering-Plough will make up-front, annual maintenance and milestone payments to the Company, fund the Company's research and development activities related to the agreement and pay the Company royalties on sales of products resulting from the collaboration. During the collaboration, the Company will discover therapeutic antibodies against targets selected by Merck/Schering-Plough, use the Company's proprietary Human Engineering™ technology to humanize antibody candidates generated by hybridoma techniques, perform preclinical studies to support regulatory filings, develop cell lines and production processes and produce antibodies for initial clinical trials. The Company will recognize revenue on the up-front and annual payments on a straight-line basis over the expected term of each target antibody discovery, on the research and development activities as they are performed on a time and materials basis, on the milestones when they are achieved and on the royalties when the underlying sales occur.

In the second quarter of 2009, the Company successfully completed the agreed-upon activities of certain programs under this collaboration and transferred these programs to Merck/Schering-Plough for continued development. As a result, the number of discovery and development programs under this collaboration was reduced. This resulted in the recognition of \$2.6 million of the remaining unamortized balance in deferred revenue pertaining to these transferred programs. In 2009, the Company recognized revenue of \$7.6 million under this agreement, compared with \$10.8 million in 2008 and \$5.7 million in 2007.

***Merck/Schering-Plough/AVEO Pharmaceuticals, Inc. ("AVEO")***

In April of 2006, the Company entered into an agreement with AVEO to utilize XOMA's Human Engineering™ technology to humanize AV-299 under which AVEO paid the Company an up-front license fee and development milestones. Under this agreement the Company created four Human Engineering™ versions of the original AV-299, all of which met design goals and from which AVEO selected one as its lead development candidate.

In September of 2006, as a result of the successful humanization of AV-299, the Company entered into a second agreement with AVEO to manufacture and supply AV-299 in support of early clinical trials. Under the agreement, the Company created AV-299 production cell lines, conducted process and assay development and performed Good Manufacturing Practices ("cGMP") manufacturing activities. AVEO retains all development and commercialization rights to AV-299 and may be required to pay the Company annual maintenance fees, additional development milestones and royalties in the future. The Company will recognize revenue on the research and development and manufacturing services as they are performed on a time and materials basis, on the maintenance fees when they are due, on the milestones when they are achieved and on the royalties when the underlying sales occur.

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

In April of 2007, Merck/Schering-Plough entered into a research, development and license agreement with AVEO concerning AV-299 and other anti-HGF molecules, under which AVEO assigned its entire right, title and interest in, to and under its manufacturing agreement with XOMA to Merck/Schering-Plough. In 2009, the Company recognized revenue of \$0.7 million under this agreement, compared with \$3.2 million in 2008 and \$8.0 million in 2007.

**UCB**

Celltech Therapeutics Ltd., now UCB Celltech, a branch of UCB, utilized the Company's bacterial cell expression technology under license in the development of CIMZIA® for the treatment of moderate-to-severe Crohn's disease and moderate-to-severe rheumatoid arthritis. The Company is entitled to receive a low single-digit royalty on sales of CIMZIA® in those countries where the Company's bacterial cell expression technology is patented, which includes the U.S. and Canada. CIMZIA® has been approved in the U.S. for the treatment of Crohn's disease and in the U.S. and Canada for the treatment of rheumatoid arthritis. The Company recognizes CIMZIA® royalty revenue when the underlying sales occur. During 2009, royalties received from sales of CIMZIA® were \$0.5 million compared with \$0.1 million in 2008.

***Genentech, Inc., a wholly-owned member of the Roche Group (referred to herein as "Genentech")***

In April of 1996, the Company entered into a collaboration agreement with Genentech for the development of RAPTIVA®. In March of 2003, it entered into amended agreements which called for the Company to share in the development costs and to receive a 25% share of future U.S. operating profits and losses and a royalty on sales outside the United States. The amended agreements also called for Genentech to finance the Company's share of development costs up until first FDA marketing approval via a convertible subordinated loan, and its share of pre-launch marketing and sales costs via an additional commercial loan facility. Under the loan agreement, upon FDA approval of the product, which occurred in October of 2003, the Company elected to pay \$29.6 million of the development loan in convertible preference shares, which are convertible into approximately 3.8 million common shares at a price of \$7.75 per common share. The commercial loan was repaid in cash in two installments in 2004.

In January of 2005, the Company announced a restructuring of its arrangement with Genentech on RAPTIVA®. Under the restructured arrangement, the Company was entitled to receive mid-single digit royalties on worldwide sales of RAPTIVA® in all indications. The previous cost and profit sharing arrangement for RAPTIVA® in the U.S. was discontinued and Genentech was responsible for all operating and development costs associated with the product. In addition, the Company's remaining obligation under the development loan was extinguished. In the first half of 2009, RAPTIVA® was withdrawn from the commercial drug markets and royalties ceased.

Genentech utilized the Company's bacterial cell expression technology under license to develop LUCENTIS® for the treatment of neovascular wet age-related macular degeneration. The Company was entitled to receive a low single-digit royalty on worldwide sales of LUCENTIS®. In the third quarter of 2009, the Company sold its LUCENTIS® royalty interest to Genentech for \$25 million, including royalty revenue from the second quarter of 2009. The Company will not receive any further royalties from sales of LUCENTIS®.

The Company recognized royalty revenue related to its agreements with Genentech of \$28.6 million in 2009, compared with \$21.0 million in 2008 and \$16.6 million in 2007.

## XOMA Ltd.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

**5. Restructuring Charges**

On January 15, 2009, the Company announced a workforce reduction of approximately 42%, or 144 employees, a majority of which were employed in manufacturing and related support functions. This decision was made based on the challenging economic conditions and a decline in forecasted contract manufacturing demand in 2009.

As part of this workforce reduction, the Company recorded charges of \$3.1 million related to severance, other termination benefits and outplacement services in 2009. Additionally, the Company vacated one of its leased buildings and recorded a restructuring charge of \$0.5 million primarily related to the net present value of the net future minimum lease payments at the cease-use date, less the estimated future sublease income. The Company is currently seeking a sublease tenant. These charges are included as restructuring expenses in the consolidated statement of operations for the year ended December 31, 2009.

The following table summarizes the restructuring charges and utilization for the year ended December 31, 2009 (in thousands):

	Balance as of December 31, 2008	Charges	Cash Payments	Adjustments	Balance as of December 31, 2009
Employee severance and benefits	\$ —	\$3,289	\$(3,098)	\$ (191)	\$ —
Facilities consolidation	—	491	(124)	7	374
Total	\$ —	\$3,780	\$(3,222)	\$ (184)	\$ 374

Employee severance and other termination benefits related to the January of 2009 workforce reduction were fully paid by the third quarter of 2009. The Company does not expect to incur any additional restructuring charges for employee severance and other termination benefits related to the January of 2009 workforce reduction. The facilities consolidation charge is recorded as both a current accrued liability and a long-term liability at December 31, 2009 since the remaining lease term of the vacated building is approximately five years.

Also, as a result of the workforce reduction, the Company significantly reduced operations in four leased buildings in the first quarter of 2009. In the second quarter of 2009, the Company resumed operations in one of these buildings and vacated another resulting in a restructuring charge, as discussed above. In the fourth quarter of 2009, the Company resumed operations in the remaining two vacant buildings, but temporarily vacated a different building in order to optimize its facility usage. As manufacturing demand increases in the future, the Company plans to resume operations at this facility.

As of December 31, 2009, the Company performed an analysis of the long-lived assets related to the vacant building, with an approximate net book value of \$4.2 million. Based on estimated undiscounted future cash inflows, the Company has determined that there is no current impairment relating to these assets, and will continue to assess for impairment at each future reporting period.

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

6. Fair Value Measurements

Effective January 1, 2008, the Company adopted ASC 820, which established a framework for measuring fair value and a fair value hierarchy that prioritizes the inputs used in valuation techniques. ASC 820 describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

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

Level 2—Observable inputs other than quoted prices in active markets for similar assets or liabilities.

Level 3—Unobservable inputs.

The following tables set forth the Company's fair value hierarchy for its financial assets (cash equivalents and investments) and liabilities measured at fair value on a recurring basis as of December 31, 2009 and 2008.

Financial assets carried at fair value as of December 31, 2009 and 2008 are classified as follows (in thousands):

	Fair Value Measurements at December 31, 2009 Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Repurchase agreements	\$ 6,504	\$ 6,504	\$ —	\$ —
Money market funds	14,340	14,340	—	—
Total	<u>\$20,844</u>	<u>\$ 20,844</u>	<u>\$ —</u>	<u>\$ —</u>

	Fair Value Measurements at December 31, 2008 Using			
	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Repurchase agreements	\$ 8,950	\$ 8,950	\$ —	\$ —
Certificates of deposit-restricted	952	952	—	—
Money market funds	10	10	—	—
Money market funds-restricted	8,593	8,593	—	—
Corporate notes and bonds	1,299	—	1,299	—
Total	<u>\$19,804</u>	<u>\$ 18,505</u>	<u>\$ 1,299</u>	<u>\$ —</u>

Financial liabilities carried at fair value as of December 31, 2009 are classified as follows (in thousands):

	Fair Value Measurements at December 31, 2009 Using			
	Total	Quoted Prices in Active Markets for Identical Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Warrant liabilities	\$4,760	\$ —	\$ —	\$ 4,760
Total	<u>\$4,760</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 4,760</u>

## XOMA Ltd.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The fair value of the warrant liabilities was determined at December 31, 2009 using the Simulation Model, as discussed in *Note 2: Basis of Presentation and Significant Accounting Policies—Significant Accounting Policies—Warrant Liabilities*. The Company did not have any financial liabilities carried at fair value as of December 31, 2008.

The following table provides a summary of changes in the fair value of the Company's Level 3 financial liabilities for the year ended December 31, 2009 (in thousands):

	Warrant Liabilities
Balance at December 31, 2008	\$ —
Initial fair value of warrants	(6,541)
Change in fair value of warrant liabilities included in other income (expense)	1,781
Balance at December 31, 2009	<u>\$ (4,760)</u>

**7. Long-Term Debt and Other Arrangements**

As of December 31, 2009, the Company had long-term debt of \$13.3 million, all of which was under its note with Novartis. As of December 31, 2008, the Company had long-term debt of \$63.3 million, including \$50.4 million outstanding under its Goldman Sachs term loan and \$12.9 million outstanding under its Novartis note. The fair value of the Company's debt approximated \$4.7 million and \$50 million at December 31, 2009 and 2008, respectively, based on the net present value of future payments discounted at interest rates consistent with the Company's then current borrowing rates offered to the Company.

***Goldman Sachs Term Loan***

In May of 2008, the Company refinanced its five-year term loan facility with Goldman Sachs, originally entered into in November of 2006, and borrowed the full amount of the facility of \$55 million. Interest on this facility was charged at an annual rate equal to the greater of (x) six-month LIBOR or (y) 3.0%, plus 8.5% and was subject to reset on April 1 and October 1 of each year. As of December 31, 2008, the interest rate was 12.3%. The debt was secured by all rights to receive payments due to the Company relating to RAPTIVA®, LUCENTIS® and CIMZIA®. Debt issuance costs under the facility of \$2 million were being amortized on a straight-line basis over the five-year life of the loan and were disclosed as current and long-term debt issuance costs on the balance sheet prior to repayment.

In addition, the Company was required to comply with certain covenants including a ratio of royalties collected to interest payable and a requirement that quarterly U.S. and outside-the-U.S. sales of RAPTIVA® and LUCENTIS® exceeded certain specified minimum levels. The Company was in compliance with these covenants as of December 31, 2008, but due to the cessation of royalties from sales of RAPTIVA® related to its market withdrawal in the first half of 2009, the Company was not in compliance with these covenants in the first quarter of 2009.

In September of 2009, the Company fully repaid its term loan facility with Goldman Sachs. Repayment of this loan facility discharged all of the Company's obligations to the lenders. The Company repaid the outstanding principal balance of \$42 million, accrued interest to the date of payment of \$2.4 million and a prepayment premium of \$2.5 million. In the third quarter of 2009, the Company recorded a loss on repayment of debt of \$3.6 million, which included the prepayment premium and the recognition of unamortized debt issuance costs of \$1.1 million. This loss was recorded as loss on debt extinguishment in the consolidated statement of operations for the year ended December 31, 2009.

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

*Novartis Note*

In May of 2005, the Company executed a secured note agreement with Novartis (then Chiron Corporation), which is due and payable in full in June of 2015. Under the note agreement, the Company borrowed semi-annually to fund up to 75% of the Company's research and development and commercialization costs under its collaboration arrangement with Novartis, not to exceed \$50 million in aggregate principal amount. Interest on the principal amount of the loan accrues at six-month LIBOR plus 2%, which was equal to 2.44% at December 31, 2009, and is payable semi-annually in June and December of each year. Additionally, the interest rate resets in June and December of each year. At the Company's election, the semi-annual interest payments can be added to the outstanding principal amount, in lieu of a cash payment, as long as the aggregate principal amount does not exceed \$50 million. The Company has made this election for all interest payments thus far. Loans under the note agreement are secured by the Company's interest in its collaboration with Novartis, including any payments owed to it thereunder.

At December 31, 2009, the outstanding principal balance under this note agreement was \$13.3 million and, pursuant to the terms of the arrangement as restructured in November of 2008, the Company will not make any additional borrowings under the Novartis note. Accrued interest of \$0.5 million, \$1.2 million and \$1.3 million was added to the principal balance of the loan for the years ended December 31, 2009, 2008 and 2007, respectively.

*Convertible Debt*

In February of 2006, the Company completed an exchange offer with holders of its 6.5% convertible senior notes due 2012 in which the Company exchanged \$60 million aggregate principal amount of its 6.5% Convertible SNAPs<sub>SM</sub> due 2012 (the "New Notes") for all \$60 million aggregate principal amount of its then outstanding convertible senior notes due 2012. The Company also issued an additional \$12 million of New Notes to the public for cash at a public offering price of 104% of principal, or \$12.5 million. The New Notes were initially convertible into approximately 38.4 million common shares at a conversion rate of 533.4756 of common shares per \$1,000 principal amount of New Notes, which is equivalent to a conversion price of approximately \$1.87 per common share.

The Company separately accounted for the additional interest payment feature of the New Notes as an embedded derivative instrument, which was measured at fair value and classified on the balance sheet with the convertible debt. Changes in the fair value of the embedded derivative were recognized in earnings as a component of other income (expense). The initial fair value of the derivative was subtracted from the carrying value of the debt, reflected as a debt discount, which was amortized as interest expense using the effective interest method through the date the notes were scheduled to mature, and separately reported as a derivative liability.

In 2006, \$27.5 million of the New Notes were converted into 18,262,264 common shares including 3,602,879 shares related to the additional interest payment feature of the notes. During the first quarter of 2007, \$42 million of the New Notes were voluntarily converted by holders through March 7, 2007, at which time the Company announced that it had elected to automatically convert all of the remaining \$2.5 million of New Notes outstanding. As a result, 25,640,187 shares were issued to effect the conversion of the principal balances. Additionally, at the time of conversion, the Company issued 1,889,317 shares and \$5.2 million in cash to satisfy the remaining additional interest payment feature related to these converted New Notes. The Company recorded a \$6.1 million charge to interest expense as a result of the revaluation of the embedded derivative related to the additional interest feature of the convertible notes.

**XOMA Ltd.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Interest Expense**

Interest expense and amortization of debt issuance costs, excluding losses on debt extinguishment, recorded as other expense in the consolidated statement of operations for the year ended December 31, 2009, 2008 and 2007 are shown below (in thousands):

	Year ended December 31,		
	2009	2008	2007
<b>Interest expense</b>			
Goldman Sachs term loan	\$ 3,932	\$ 5,095	\$ 3,360
Novartis note	455	1,181	1,329
Convertible debt	—	—	6,452
Other	14	—	—
Total interest expense	<u>\$ 4,401</u>	<u>\$ 6,276</u>	<u>\$ 11,141</u>
<b>Amortization of debt issuance costs</b>			
Goldman Sachs term loan	\$ 487	\$ 726	\$ 444
Total amortization of debt issuance costs	<u>\$ 487</u>	<u>\$ 726</u>	<u>\$ 444</u>
<b>Total interest expense</b>	<u>\$ 4,888</u>	<u>\$ 7,002</u>	<u>\$ 11,585</u>

**8. Income Taxes**

The total provision for income taxes consists of the following:

	Year ended December 31,		
	2009	2008	2007
Federal income tax provision	\$ (113)	\$(384)	\$—
State income tax provision	6	—	—
Foreign income tax provision	5,834	1	—
Total	<u>\$5,727</u>	<u>\$(383)</u>	<u>\$—</u>

Income tax expense in 2009 was primarily related to \$5.8 million of foreign income tax expense recognized in connection with the expansion of the Company's existing collaboration with Takeda in February of 2009. The Company was paid a \$29 million expansion fee, of which \$5.8 million was withheld for payment to the Japanese taxing authority. The Company also recognized \$0.1 million of income tax benefit for 2009 relating to research and development refundable credits, in addition to the \$0.4 million in research and development refundable credits recognized in 2008.

The significant components of net deferred tax assets as of December 31, 2009 and 2008 were as follows (in millions):

	December 31,	
	2009	2008
Capitalized research and development expenses	\$ 65.7	\$ 79.6
Net operating loss carryforwards	93.3	103.5
Research and development and other credit carryforwards	20.0	20.6
Other	10.9	11.0
Total deferred tax assets	189.9	214.7
Valuation allowance	(189.9)	(214.7)
Net deferred tax assets	<u>\$ —</u>	<u>\$ —</u>

**XOMA Ltd.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The net increase (decrease) in the valuation allowance was \$(24.8) million, \$9.1 million and \$42.3 million for the years ended December 31, 2009, 2008 and 2007, respectively. Approximately \$13.1 million in unutilized federal net operating loss carry-forwards expired in 2009.

ASC 740 provides for the recognition of deferred tax assets if realization of such assets is more likely than not. Based upon the weight of available evidence, which includes the Company's historical operating performance and carry-back potential, the Company has determined that total deferred tax assets should be fully offset by a valuation allowance.

As of December 31, 2009, the Company had accumulated federal tax net operating loss carry-forwards of \$113 million, with expiration dates from 2018 to 2028, federal tax credit carry-forwards of \$9.4 million, with expiration dates from 2010 to 2028, state tax net operating loss carry-forwards of \$133.0 million, with expiration dates from 2014 to 2029, state tax credit carry-forwards of \$15.7 million, without expiration, and foreign tax net operating loss carry-forwards of \$376.8 million, without expiration. In 2009, the Company experienced an "ownership change" under Section 382 of the Internal Revenue Code, which subjects the amount of federal and state tax carry-forwards that can be utilized to an annual limitation, which will substantially limit the Company's future use of these carry-forwards per year. To the extent that the Company does not utilize its carry-forwards within the applicable statutory carry-forward periods, either because of Section 382 limitations or the lack of sufficient taxable income, the carry-forwards will expire unused.

The Company files income tax returns in the U.S. federal jurisdiction, State of California and Ireland. The Company's federal income tax returns for tax years 2006 and beyond remain subject to examination by the Internal Revenue Service. The Company's California and Irish income tax returns of the tax years 2005 and beyond remain subject to examination by the Franchise Tax Board and Irish Revenue Commissioner. In addition, all of the net operating losses and research and development credit carry-forwards that may be used in future years are still subject to adjustment.

The Company did not have unrecognized tax benefits as of December 31, 2009 and does not expect this to change significantly over the next twelve months. The Company will recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of December 31, 2009, the Company has not accrued interest or penalties related to uncertain tax positions.

**9. Compensation and Other Benefit Plans**

**Incentive Compensation Plans**

The Board of Directors established a Management Incentive Compensation Plan ("MICP") effective July 1, 1993, in which management employees (other than the Chief Executive Officer), as well as certain additional discretionary participants chosen by the Chief Executive Officer, are eligible to participate. The Chief Executive Officer is covered under a CEO Incentive Compensation Plan ("CICP") which was established by the Board of Directors effective January 1, 2004. Employees that do not qualify under the MICP or CICP are covered under the Bonus Compensation Plan ("BCP") effective January 1, 2007. As of January 1, 2007, awards earned under the MICP, CICP and BCP are payable in cash during the first quarter of the following fiscal year so long as the participant remains an employee of the Company.

In October of 2007, the Board of Directors approved amendments to the incentive plans eliminating the requirement for bonus awards to be paid partially in shares. Beginning with awards related to the year ended December 31, 2007, the bonus awards are paid entirely in cash.

**XOMA Ltd.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The amounts charged to expense under the incentive plans were \$3.7 million, zero and \$4.0 million for the plan years 2009, 2008 and 2007, respectively.

**Employee Share Purchase Plan**

In 1998, the Company's shareholders approved the 1998 Employee Share Purchase Plan which provides employees of the Company the opportunity to purchase common shares through payroll deductions. Up to 1,500,000 common shares are authorized for issuance under the Share Purchase Plan. An employee may elect to have payroll deductions made under the Share Purchase Plan for the purchase of common shares in an amount not to exceed 15% of the employee's compensation.

Effective January 1, 2005, the plan was amended to reduce future offering periods to three months and to change the purchase price per common share to 95% of the closing price of XOMA shares on the exercise date.

In 2009, 2008, and 2007, employees purchased 221,033, 195,403 and 83,338 common shares, respectively, under the Employee Share Purchase Plan. Net payroll deductions under the Share Purchase Plan totaled \$0.1 million, \$0.3 million and \$0.3 million for 2009, 2008 and 2007, respectively.

**Deferred Savings Plan**

Under section 401(k) of the Internal Revenue Code of 1986, the Board of Directors adopted, effective June 1, 1987, a tax-qualified deferred compensation plan for employees of the Company. Participants may make contributions which defer up to 50% of their eligible compensation per payroll period, up to a maximum for 2009 of \$16,500 (or \$22,000 for employees over 50 years of age). The Company may, at its sole discretion, make contributions each plan year, in cash or in the Company's common shares, in amounts which match up to 50% of the salary deferred by the participants. The expense related to these contributions was \$0.9 million, \$1.1 million and \$1.0 million for the years ended December 31, 2009, 2008 and 2007, respectively, and 100% was paid in common shares in each year.

**Share Options**

At December 31, 2009, the Company had share-based compensation plans, as described below. The aggregate number of common shares that may be issued under these plans is 34,815,000 shares.

In February of 2009, the Board of Directors approved a company-wide grant of 4,730,000 share options, of which 4,568,000 were issued as part of the Company's annual incentive compensation package. These options vest monthly over four years and include an acceleration clause based on meeting certain performance measures. In the third quarter of 2009, management determined that it was probable that the performance measures would be achieved. The Company accelerated expense recognition related to these options, with an estimated implicit service period of twelve months from the grant date, which was subsequently extended an additional twelve months in the fourth quarter of 2009 based on revised assumptions.

**Share Option Plan**

Under the Company's amended 1981 Share Option Plan ("Option Plan") the Company grants qualified and non-qualified share options to employees and other individuals, as determined by the Board of Directors, at exercise prices of not less than the fair market value of the Company's common shares on the date of grant. Options granted under the Option Plan may be exercised when vested and generally expire ten years from the date of the grant or three months from the date of termination of employment (longer in case of death or certain

**XOMA Ltd.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

retirements). Options granted generally vest over four years. However, certain options may vest monthly or immediately, and certain options fully vest upon a change of control of the Company or may accelerate based on performance-driven measures. The Option Plan will terminate on November 15, 2011.

Up to 32,100,000 shares are authorized for issuance under the Option Plan. As of December 31, 2009, options covering 20,554,033 common shares were outstanding under the Option Plan.

**Restricted Share Plan**

The Company also has a Restricted Share Plan (“Restricted Plan”) which provides for the issuance of options or grants of common shares to certain employees and other individuals as determined by the Board of Directors at fair market value of the common shares on the grant date. Prior to 2005, options or shares could be granted at not less than 85% of fair market value of the common shares on the grant date. Each option issued under the Restricted Plan will be a non-statutory share option under federal tax laws and will have a term not in excess of ten years from the grant date or three months from the date of termination of employment (longer in the case of death or certain retirements). Options granted generally vest over four years and certain options may fully vest upon a change of control of the Company. The Restricted Plan will terminate on November 15, 2011.

Up to 2,750,000 shares are authorized for issuance under the Restricted Plan, subject to the condition that not more than 32,100,000 shares are authorized under both the Option Plan and the Restricted Plan. As of December 31, 2009, options covering 948,372 common shares were outstanding under the Restricted Plan.

**Directors Share Option Plan and Other Options**

In 1992, the shareholders approved a Directors Share Option Plan (“Directors Plan”) which provides for the issuance of options to purchase common shares to non-employee directors of the Company at 100% of the fair market value of the shares on the date of the grant. Up to 1,600,000 shares are authorized for issuance during the term of the Directors Plan. Options generally vest on the date of grant, or monthly over one year or three years and have a term of up to ten years. As of December 31, 2009, options for 1,132,500 common shares were outstanding under the Directors Plan.

In addition, in July of 2002, the Company granted a non-qualified fully-vested option to a director to purchase 15,000 common shares at 100% of the fair market value of the shares on the date of grant, which will expire in ten years. This option was not issued as part of the Directors Plan.

In August of 2007, the Company granted a non-qualified option to Steven B. Engle, CEO, to purchase 1,100,000 common shares at 100% of the fair market value of the shares on the date of grant. The option is subject to the Company’s typical four-year vesting schedule and will expire 10 years from the date of issuance. This option was not issued as part of the Company’s Option Plan or the Restricted Plan.

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Share Option Plans Summary

A summary of the status of the Company's share option plans as of December 31, 2009, 2008 and 2007, and changes during the years ended on those dates is presented below:

Options:	2009		2008		2007	
	Shares	Price*	Shares	Price*	Shares	Price*
Outstanding at beginning of year	19,810,183	\$ 3.24	11,108,120	\$ 3.66	6,229,864	\$ 4.22
Granted						
(1)	6,486,000	0.60	2,784,750	1.59	5,545,850	2.95
(2)	—	—	8,691,000	3.28	500,000	5.00
Exercised	(30,833)	0.56	(85,740)	1.54	(252,920)	1.60
Forfeited, expired or cancelled (3)	(3,463,817)	2.76	(2,687,947)	3.46	(914,674)	4.50
Outstanding at end of year	<u>22,801,533</u>	<u>2.56</u>	<u>19,810,183</u>	<u>3.24</u>	<u>11,108,120</u>	<u>3.66</u>
Exercisable at end of year	<u>12,346,439</u>	<u>3.27</u>	<u>8,575,803</u>	<u>3.94</u>	<u>5,261,399</u>	<u>4.67</u>
Weighted average fair value of options granted						
(1)		\$ 0.39		\$ 0.94		\$ 1.80
(2)		—		\$ 0.99		\$ 0.89

\* Weighted-average exercise price:

- (1) Option price equal to market price on date of grant.
- (2) Option price greater than market price on date of grant
- (3) The Company adjusts for forfeitures as they occur.

At December 31, 2009, there were 20,534,145 options vested and expected to vest with a weighted-average exercise price of \$2.64. The weighted average remaining contractual term of outstanding share options at December 31, 2009 was 7.3 years and the aggregate intrinsic value was \$0.6 million. The weighted average remaining contractual term of exercisable share options at December 31, 2009 was 6.5 years and the aggregate intrinsic value was \$0.2 million.

Share-Based Compensation Expense

The following table shows total share-based compensation expense included in the consolidated statements of operations for the years ended December 31, 2009, 2008 and 2007 (in thousands):

	Year Ended December 31,		
	2009	2008	2007
Research and development	\$ 2,182	\$ 2,307	\$ 1,005
Selling, general and administrative	2,213	2,627	1,853
Total share-based compensation expense	<u>\$ 4,395</u>	<u>\$ 4,934</u>	<u>\$ 2,858</u>

There was no capitalized share-based compensation cost as of December 31, 2009 or 2008, and there were no recognized tax benefits related to the Company's share-based compensation expense during the years ended December 31, 2009 or 2008.

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The fair value of share-based awards was estimated using the Black-Scholes model with the following weighted average assumptions for the years ended December 31, 2009, 2008 and 2007:

	Year Ended December 31,		
	2009	2008	2007
Dividend yield	0%	0%	0%
Expected volatility	75%	65%	67%
Risk-free interest rate	2.00%	2.84%	4.22%
Expected term	5.6 years	5.4 years	5.3 years

Unvested share option activity for the year ended December 31, 2009 is summarized below:

	Unvested Number of Shares	Weighted- Average Grant- Date Fair Value
Unvested balance at December 31, 2008	11,234,380	\$ 2.17
Granted	6,486,000	0.60
Vested	(5,210,488)	1.81
Forfeited	(2,054,798)	2.08
Unvested balance at December 31, 2009	<u>10,455,094</u>	<u>1.39</u>

At December 31, 2009, there was \$6.8 million of unrecognized share-based compensation expense related to unvested share options with a weighted average remaining recognition period of 2.3 years. The estimated fair value of options vested during 2009, 2008 and 2007 was \$4.1 million, \$3.6 million and \$0.4 million, respectively. Total intrinsic value of the options exercised was \$6,000 in 2009, \$50,000 in 2008 and \$0.4 million in 2007. Total cash received from share option exercises in 2009 was \$17,000.

**10. Share Capital**

**Preference Shares**

As of December 31, 2009, the Company had the authority to issue 1,000,000 preference shares with a par value of \$0.05 per share. Of these, 210,000 preference shares have been designated Series A Preference Shares and 8,000 preference shares have been designated Series B Preference Shares.

- Series A: As of December 31, 2009, the Company has authorized 210,000 Series A Preference Shares of which none were outstanding at December 31, 2009 or 2008. Refer to *Shareholder Rights Plan* section below.
- Series B: As of December 31, 2009, the Company has authorized 8,000 Series B Preference Shares. In December of 2003, the Company issued 2,959 of the Series B preference shares to Genentech in repayment of \$29.6 million of the outstanding balance under a convertible subordinated debt agreement. Pursuant to the rights of the Series B preference shares, the holders of Series B preference shares will not be entitled to receive any dividends on the Series B preference shares. The Series B preference shares will rank senior with respect to rights on liquidation, winding-up and dissolution of the Company to all classes of common shares. Upon any voluntary or involuntary liquidation, dissolution or winding-up of the Company, holders of Series B preference shares will be entitled to receive \$10,000 per share of Series B preference shares before any distribution is made on the common shares. The holder of the Series B preference shares has no voting rights, except as required under Bermuda law.

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

The holder of Series B preference shares has the right to convert Series B preference shares into common shares at a conversion price equal to \$7.75 per common share, subject to adjustment in certain circumstances. Accordingly, the 2,959 issued Series B preference shares are convertible into 3,818,395 common shares.

The Series B preference shares will be automatically converted into common shares at their then effective conversion rate immediately upon the transfer by the initial holder to any third party which is not an affiliate of such holder. The Company will have the right, at any time and from time to time, to redeem any or all Series B preference shares for cash in an amount equal to the conversion price multiplied by the number of common shares into which each such share of Series B preference shares would then be convertible.

**Shareholder Rights Plan**

On February 26, 2003, the Company's Board of Directors unanimously adopted a Shareholder Rights Plan ("Rights Plan"), which was designed to extend the provisions of a similar rights plan originally adopted in October of 1993. Under the Rights Plan, Preference Share Purchase Rights ("Rights") are authorized and granted at the rate of one Right for each outstanding common share. Each Right entitles the registered holder of common shares to buy a fraction of a share of the new series of Preference Shares ("Series A Preference Shares") at an exercise price of \$30.00, subject to adjustment. The Rights will be exercisable and will detach from the common share, only if a person or group acquires 20 percent or more of the common shares, announces a tender or exchange offer that if consummated will result in a person or group beneficially owning 20 percent or more of the common shares or if the Board of Directors declares a person or group owning 10 percent or more of the outstanding common shares to be an Adverse Person (as defined in the Rights Plan). Once exercisable, each Right will entitle the holder (other than the acquiring person) to purchase units of Series A Preference Share (or, in certain circumstances, common shares of the acquiring person) with a value of twice the Rights' exercise price. The Company will generally be entitled to redeem the Rights at \$0.001 per Right at any time until the close of business on the tenth day after the Rights become exercisable. The Rights will expire at the close of business on February 26, 2013.

**Shares Reserved for Future Issuance**

The Company has reserved common shares for future issuance as of December 31, 2009, as follows:

Share option plans	30,941,503
Employee share purchase plan	55,780
Convertible preference shares	3,818,395
Warrants	11,099,744
Total	<u>45,915,422</u>

**ATM Agreement**

In the third quarter of 2009, the Company entered into an At Market Issuance Sales Agreement (the "ATM Agreement"), with Wm Smith & Co. ("Wm Smith"), under which the Company may sell up to 25 million of its common shares from time to time through Wm Smith, as the agent for the offer and sale of the common shares. Wm Smith may sell these common shares by any method permitted by law deemed to be an "at the market" offering as defined in Rule 415 of the Securities Act of 1933, including but not limited to sales made directly on The NASDAQ Global Market, on any other existing trading market for the common shares or to or through a market maker. Wm Smith may also sell the common shares in privately negotiated transactions, subject to the

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Company's approval. The Company pays Wm Smith a commission equal to 3% of the gross proceeds of all common shares sold through it as sales agent under the ATM Agreement but in no event less than \$0.02 per share. Shares sold under the ATM Agreement are sold pursuant to a prospectus which forms a part of a registration statement declared effective by the Securities and Exchange Commission on May 29, 2008. From the inception of the ATM Agreement through December 31, 2009, the Company sold a total of 4,050,617 common shares through Wm Smith for aggregate gross proceeds of \$2.9 million. Total offering expenses related to these sales were \$0.1 million. See *Note 14: Subsequent Events* for additional disclosure regarding the number of common shares sold under this agreement subsequent to the end of 2009.

**Registered Direct Offerings**

In May of 2009, the Company entered into a definitive agreement with an institutional investor to sell 11,764,706 units, with each unit consisting of one of the Company's common shares and a warrant to purchase 0.50 of a common share, for gross proceeds of approximately \$10 million, before deducting placement agent fees and estimated offering expenses of \$0.8 million, in a registered direct offering. The investor purchased the units at a price of \$0.85 per unit. The warrants, which represent the right to acquire an aggregate of up to 5,882,353 common shares, were exercisable at any time on or after May 15, 2009 and prior to May 20, 2014 at an exercise price of \$1.02 per share.

In June of 2009, the Company entered into a definitive agreement with certain institutional investors to sell 10,434,782 units, with each unit consisting of one of the Company's common shares and a warrant to purchase 0.50 of a common share, for gross proceeds of approximately \$12 million, before deducting placement agent fees and estimated offering expenses of \$0.8 million, in a second registered direct offering. The investor purchased the units at a price of \$1.15 per unit. The warrants, which represent the right to acquire an aggregate of up to 5,217,391 common shares, are exercisable at any time on or prior to December 10, 2014 at an exercise price of \$1.30 per share.

As discussed in *Note 2: Basis of Presentation and Significant Accounting Policies—Significant Accounting Policies—Warrant Liabilities*, the fair value of the warrants at the issuance dates was estimated using the Simulation Model, and the Company recorded liabilities of \$2.9 million and \$3.6 million for the May and June warrant issuances, respectively. The Company revalued the warrants at December 31, 2009 and recorded a decrease in the fair value of the warrants of \$1.8 million in the other income line item of the Company's consolidated statement of operations.

See *Note 14: Subsequent Events* for additional disclosure regarding certain amendments to the warrants issued in May and June of 2009 and the number of shares issued upon exercise of the warrants issued in May of 2009 subsequent to the end of 2009.

**Equity Line of Credit**

On October 21, 2008, the Company entered into a common share purchase agreement (the "Purchase Agreement") with Azimuth Opportunity Ltd. ("Azimuth"), pursuant to which it obtained a committed equity line of credit facility (the "Facility") under which the Company could sell up to \$60 million of its registered common shares to Azimuth over a 24-month period, subject to certain conditions and limitations. The Purchase Agreement required a minimum share price of \$1.00 per share to allow the Company to issue shares to Azimuth under the Facility. However, at its election, Azimuth could buy shares below the threshold price at a negotiated discount. The Company was not obligated to utilize any of the \$60 million Facility and remained free to enter other financing transactions. Shares under the Facility were sold pursuant to a prospectus which forms a part of a registration statement declared effective by the Securities and Exchange Commission on May 29, 2008. At the end of the third quarter of 2009, the Facility was no longer in effect, and no additional shares could be issued thereunder.

**XOMA Ltd.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

From the inception of the Facility in October of 2008 through December 31, 2009, the Company sold a total of 42,228,428 common shares to Azimuth for aggregate gross proceeds of \$33.9 million. This included the sale of 4.0 million shares under the Facility in December of 2008 and 34.3 million shares in two transactions in September of 2009 that Azimuth agreed to purchase notwithstanding that the purchase prices were below the minimum price of \$1.00 required by the Purchase Agreement. Under the terms of the Purchase Agreement, the Company negotiated a discount rate (excluding placement agent fees) of 8.86% for the sale in December of 2008 and 8.0% for the sales in September of 2009. Prior to the successful conclusion of negotiations, Azimuth was not obligated to purchase these shares. Offering expenses incurred from inception of the Facility through December 31, 2009 related to sales to Azimuth were \$0.7 million.

**Other Warrants**

In July of 2008, the remaining 125,000 warrants issued to Incyte Corporation expired. These warrants, to purchase common shares at \$6.00 per share, were issued in July of 1998 as partial payment of license fees.

**11. Commitments and Contingencies****Collaborative Agreements, Royalties and Milestone Payments**

The Company is obligated to pay royalties, ranging generally from 1.5% to 5% of the selling price of the licensed component and up to 40% of any sublicense fees to various universities and other research institutions based on future sales or licensing of products that incorporate certain products and technologies developed by those institutions.

In addition, the Company has committed to make potential future “milestone” payments to third parties as part of licensing and development programs. Payments under these agreements become due and payable only upon the achievement of certain developmental, regulatory and/or commercial milestones. Because it is uncertain if and when these milestones will be achieved, such contingencies, aggregating up to \$79 million have not been recorded on the consolidated balance sheet. The Company is unable to determine precisely when and if payment obligations under the agreements will become due as these obligations are based on milestone events, the achievement of which is subject to a significant number of risks and uncertainties.

**Leases**

As of December 31, 2009, the Company leased administrative, research facilities, and office equipment under operating leases expiring on various dates through May of 2014. These leases generally require the Company to pay taxes, insurance, maintenance and minimum lease payments.

The Company estimates future minimum lease commitments to be (in thousands):

	<b>Operating Leases</b>
2010	5,307
2011	5,290
2012	4,947
2013	2,904
2014	796
Thereafter	—
Minimum lease payments	<u>\$ 19,244</u>

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Total rental expense, including other costs required under the Company's leases, was approximately \$5.2 million, \$5.2 million and \$4.6 million for the years ended December 31, 2009, 2008 and 2007, respectively. Rental expense based on leases allowing for escalated rent payments are recognized on a straight-line basis. The Company is required to restore certain of its leased property to certain conditions in place at the time of lease. The Company believes these costs will not be material to its operations.

**Legal Proceedings**

On April 9, 2009, a complaint was filed in the Superior Court of Alameda County, California, in a lawsuit captioned *Hedrick et al. v. Genentech, Inc. et al*, Case No. 09-446158. The complaint asserts claims against Genentech, the Company and others for alleged strict liability for failure to warn, strict product liability, negligence, breach of warranty, fraudulent concealment, wrongful death and other claims based on injuries alleged to have occurred as a result of three individuals' treatment with RAPTIVA®. The complaint seeks unspecified compensatory and punitive damages. Since then, additional complaints have been filed in the same court, bringing the total number of pending cases to twenty-one. All of the complaints allege the same claims and seek the same types of damages based on injuries alleged to have occurred as a result of the plaintiffs' treatment with RAPTIVA®. The Company's agreement with Genentech provides for an indemnity of XOMA and payment of legal fees by Genentech which the Company believes is applicable to this matter. The Company believes the claims against it to be without merit and intends to defend against them vigorously.

In September of 2004, XOMA (US) LLC entered into a collaboration with Aphton Corporation ("Aphton") for the treatment of gastrointestinal and other gastrin-sensitive cancers using anti-gastrin monoclonal antibodies. In May of 2006, Aphton filed for bankruptcy protection under Chapter 11, Title 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware, No. 06-10510 (CSS). XOMA (US) LLC filed a proof of claim in the proceeding, as an unsecured creditor of Aphton, for approximately \$594,000. Aphton and the Official Committee of Unsecured Creditors filed a Proposed Plan of Reorganization (the "Plan") that would result in a liquidation of Aphton. The creditors have voted in favor of the plan, and the bankruptcy court has confirmed it. A litigation trustee appointed under the Plan is currently pursuing litigation against various parties other than the Company, and any recovery by the Company under the Plan will depend on the outcome of such litigation. It is not presently known what, if any, distributions will be made to holders of unsecured claims. There were no developments material to XOMA in the proceedings involving Aphton during the year ended December 31, 2009.

**12. Related Party Transactions**

There were no related party transactions in 2009. Related party transactions during the years ended December 31, 2008 and 2007 consisted of relocation loans to two employees. The final balance of these loans was forgiven in November of 2008. The initial loans of \$70,000 and \$150,000 were granted in 2001 and 2004, respectively, and were forgiven, along with related interest, over five and two-thirds and four years, respectively, contingent on the employees continued employment with the Company. Total related party balances as of December 31, 2008 and 2007 were zero and \$38,000, respectively.

**13. Concentration of Risk, Segment and Geographic Information**

**Concentration of Risk**

Cash equivalents, short-term investments and receivables are financial instruments, which potentially subject the Company to concentrations of credit risk. The Company maintains money market funds and short-term investments that were previously thought to bear a minimal risk. Volatility in the financial markets created

**XOMA Ltd.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

liquidity problems in these types of investments in 2008, and money market fund investors were unable to retrieve the full amount of funds, even in highly-rated liquid money market accounts, upon maturity. The Company has not encountered such issues during 2009.

The Company has not experienced any significant credit losses and does not generally require collateral on receivables. In 2009, two customers represented 36% and 29% of total revenue and as of December 31, 2009, there were receivables of \$5.7 million outstanding from three customers representing 90% of the accounts receivable balance.

In 2008, three customers represented 31%, 30% and 20% of total revenue and as of December 31, 2008, there were billed receivables of \$14.7 million outstanding from these three customers and one additional customer representing 33%, 28%, 16% and 15% of the accounts receivable balance. In 2007, four customers represented 36%, 20%, 16% and 13% of total revenue.

***Segment Information***

The Company has determined that it operates in one segment as it only reports operating results on an aggregate basis to the chief operating decision maker of the Company. The Company's property and equipment is held entirely in the United States.

***Geographic Information***

Revenue attributed to the following countries for each of the three years ended December 31, 2009, 2008 and 2007 was as follows (in thousands):

	Year ended December 31,		
	2009	2008	2007
United States	\$ 47,656	\$ 62,262	\$ 80,573
Europe	613	1,351	561
Asia Pacific	50,161	4,374	3,118
Total	<u>\$ 98,430</u>	<u>\$ 67,987</u>	<u>\$ 84,252</u>

**14. Subsequent Events**

***Underwritten Offering***

On February 2, 2010, the Company entered into an underwritten offering with investors to sell 42 million units, with each unit consisting of one of the Company's common shares and a warrant to purchase 0.45 of a common share, for gross proceeds of approximately \$21 million, before deducting underwriting discounts and commissions and estimated offering expenses of \$1.7 million. The investors purchased the units at a price of \$0.50 per unit. The warrants, which represent the right to acquire an aggregate of up to 18.9 million common shares, are exercisable beginning six months and one day after issuance and have a five-year term and an exercise price of \$0.70 per share.

***Warrant Amendments and Exercises***

Also on February 2, 2010, the warrant holders agreed to amend the terms of the warrants issued in May and June of 2009 to eliminate the provisions that would have required reduction of the warrant exercise price and an increase in the number of shares issuable on exercise of the warrants each time the Company sold common

XOMA Ltd.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

shares at a price less than the exercise price of such warrants. In return, the exercise price of the warrants issued in May of 2009 was reduced from \$1.02 per share to \$0.001 per share and the Company made a \$4.5 million payment to holders of the warrants issued in June of 2009. The exercise price of the warrants issued in June of 2009 remained unchanged at \$1.30 per share. In February of 2010, the holders of warrants issued in May of 2009 exercised warrants to acquire 5,882,353 common shares for an aggregate exercise price of \$5,882, and as a result no warrants issued in May of 2009 remain outstanding.

**Common Shares Sold Under the ATM Agreement**

Subsequent to December 31, 2009, the Company sold an additional 8,940,225 common shares through Wm Smith for aggregate gross proceeds of \$6.4 million. Total offering expenses related to these sales were \$0.2 million.

**15. Quarterly Financial Information (unaudited)**

The following is a summary of the quarterly results of operations for the years ended December 31, 2009 and 2008:

	Consolidated Statements of Operations			
	Quarter Ended			
	March 31	June 30	September 30	December 31
	(In thousands, except per share amounts)			
<b>2009</b>				
Total revenues (1)	\$ 39,704	\$ 9,706	\$ 27,423	\$ 21,597
Total operating costs and expenses (2)	25,930	19,474	20,643	19,423
Other income (expense), net	(1,735)	(529)	(4,872)	453
Net income (loss)	<u>6,239</u>	<u>(10,210)</u>	<u>1,538</u>	<u>2,983</u>
Basic and diluted net income (loss) per common share	<u>\$ 0.04</u>	<u>\$ (0.07)</u>	<u>\$ 0.01</u>	<u>\$ 0.01</u>
<b>2008</b>				
Total revenues (1)	\$ 12,057	\$ 11,116	\$ 7,894	\$ 36,920
Total operating costs and expenses (2)	25,083	29,907	26,438	25,293
Other expense, net (3)	(1,149)	(1,899)	(1,818)	(2,028)
Net income (loss)	<u>(14,175)</u>	<u>(20,690)</u>	<u>(20,362)</u>	<u>9,982</u>
Basic and diluted net income (loss) per common share	<u>\$ (0.11)</u>	<u>\$ (0.16)</u>	<u>\$ (0.15)</u>	<u>\$ 0.07</u>

- (1) Revenue in the first quarter of 2009 includes a non-recurring fee of \$28.1 million related to the expansion of the Company's collaboration agreement with Takeda. Revenue in the third quarter of 2009 includes a non-recurring fee of \$22.3 million related to the sale of the LUCENTIS® royalty interest to Genentech. Revenue in the fourth quarter of 2009 includes fees of \$14.0 million related to two antibody discovery collaborations. Revenue in the quarter ended December 31, 2008 includes a non-recurring fee from Novartis of \$13.7 million relating to a restructuring of the existing collaboration agreement. Revenue in the quarter ended September 30, 2007 includes a \$30 million non-recurring license fee from Pfizer.
- (2) Operating expenses in the first and second quarters of 2009 include restructuring expense of \$3.3 million and \$0.3 million, respectively. Operating expenses for the quarter ended December 31, 2008 include a reversal of the bonus accrual of \$3.0 million, as the Company determined it would not pay 2008 bonuses.
- (3) Other expense for the third quarter of 2009 includes a loss of \$3.6 million on debt extinguishment relating to the repayment of the Goldman Sachs term loan. Other income in the second, third and fourth quarter of 2009 of \$1.0 million, \$0.2 million and \$0.6 million, respectively was recorded relating to the revaluation of the warrant liabilities in 2009.

**Index to Exhibits**

<u>Exhibit Number</u>	
1.1	Underwriting Agreement dated February 2, 2010 (Exhibit 10.1) <sup>1</sup>
3.1	Memorandum of Continuance of XOMA Ltd. (Exhibit 3.4) <sup>2</sup>
3.2	Bye-Laws of XOMA Ltd. (as amended) (Exhibit 3.2) <sup>3</sup>
4.1	Shareholder Rights Agreement dated as of February 26, 2003, by and between XOMA Ltd. and Mellon Investor Services LLC as Rights Agent (Exhibit 4.1) <sup>4</sup>
4.2	Resolution Regarding Preferences and Rights of Series A Preference Shares (Exhibit A to Exhibit 4.1) <sup>5</sup>
4.3	Resolution Regarding Preferences and Rights of Series B Preference Shares (Exhibit B to Exhibit 3) <sup>6</sup>
4.4	Form of Common Stock Purchase Warrant (Incyte Warrants) (Exhibit 2) <sup>5</sup>
4.5	Indenture between XOMA Ltd. and Wells Fargo Bank, National Association, as trustee, relating to the Company's 6.50% Convertible SNAPs <sub>SM</sub> due February 1, 2012 (Exhibit 2) <sup>5</sup>
4.6	Form of Warrant (May 2009 Warrants) (Exhibit 10.2) <sup>6</sup>
4.7	Form of Warrant (June 2009 Warrants) (Exhibit 10.2) <sup>7</sup>
4.8	Form of Warrant (February 2010 Warrants) (Exhibit 10.2) <sup>1</sup>
4.9	Form of Amended and Restated Warrant (May 2009 Warrants) (Exhibit 10.5) <sup>1</sup>
4.10	Form of Amended and Restated Warrant (June 2009 Warrants) (Exhibit 10.6) <sup>1</sup>
5.1	Legal Opinion of Conyers Dill & Pearman Regarding Shares Issued Pursuant to At Market Issuance Sales Agreement*
10.1	1981 Share Option Plan as amended and restated (Exhibit 10.1) <sup>8</sup>
10.1A	Form of Share Option Agreement for 1981 Share Option Plan (Exhibit 10.1A) <sup>9</sup>
10.1B	Amendment to 1981 Share Option Plan (Exhibit 10.1B) <sup>10</sup>
10.1C	Amendment No. 2 to 1981 Share Option Plan (Exhibit 10.1C) <sup>10</sup>
10.1D	Amendment No. 3 to 1981 Share Option Plan (Exhibit 10.1) <sup>11</sup>
10.2	Restricted Share Plan as amended and restated (Exhibit 10.3) <sup>8</sup>
10.2A	Form of Share Option Agreement for Restricted Share Plan (Exhibit 10.2A) <sup>9</sup>
10.2B	Amendment to Restricted Share Plan (Exhibit 10.2C) <sup>10</sup>
10.2C	Amendment No. 2 to Restricted Share Plan (Exhibit 10.2D) <sup>10</sup>
10.2D	Amendment No. 3 to Restricted Share Plan (Exhibit 10.2D) <sup>9</sup>
10.2E	Amendment No. 4 to Restricted Share Plan (Exhibit 10.2) <sup>11</sup>
10.2F	2007 CEO Share Option Plan (Exhibit 10.7) <sup>12</sup>
10.3	1992 Directors Share Option Plan as amended and restated (Exhibit 10.3) <sup>9</sup>
10.3A	Amendment No. 1 to 1992 Directors Share Option Plan <sup>3</sup>
10.3B	Form of Share Option Agreement for 1992 Directors Share Option Plan (initial grants) (Exhibit 10.3A) <sup>9</sup>
10.3C	Form of Share Option Agreement for 1992 Directors Share Option Plan (subsequent grants) (Exhibit 10.3B) <sup>9</sup>
10.3D	2002 Director Share Option Plan (Exhibit 10.10) <sup>8</sup>

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<u>Exhibit Number</u>	
10.4	Management Incentive Compensation Plan as amended and restated (Exhibit 10.3) <sup>1</sup>
10.4A	CEO Incentive Compensation Plan (Exhibit 10.4A) <sup>9</sup>
10.4B	Bonus Compensation Plan (Exhibit 10.4B) <sup>9</sup>
10.5	1998 Employee Share Purchase Plan as amended and restated (Exhibit 10.11) <sup>8</sup>
10.5A	Amendment to 1998 Employee Share Purchase Plan (Exhibit 10.5A) <sup>10</sup>
10.5B	Amendment No. 2 to 1998 Employee Share Purchase Plan (Exhibit 10.5B) <sup>10</sup>
10.6	Form of Amended and Restated Indemnification Agreement for Officers (Exhibit 10.6) <sup>4</sup>
10.6A	Form of Amended and Restated Indemnification Agreement for Employee Directors (Exhibit 10.7) <sup>4</sup>
10.6B	Form of Amended and Restated Indemnification Agreement for Non-employee Directors (Exhibit 10.8) <sup>4</sup>
10.7	Form of Employment Agreement entered into between XOMA (US) LLC and certain of its executives, with reference schedule*
10.7A	Consulting Agreement effective as of August 3, 2007 between XOMA (US) LLC and John L. Castello (Exhibit 10.8) <sup>2</sup>
10.8	Form of Change of Control Severance Agreement entered into between XOMA Ltd. and certain of its executives, with reference schedule*
10.9	Lease of premises at 890 Heinz Street, Berkeley, California dated as of July 22, 1987 (Exhibit 10.12) <sup>5</sup>
10.10	Lease of premises at Building E at Aquatic Park Center, Berkeley, California dated as of July 22, 1987 and amendment thereto dated as of April 21, 1988 (Exhibit 10.13) <sup>15</sup>
10.11	Lease of premises at Building C at Aquatic Park Center, Berkeley, California dated as of July 22, 1987 and amendment thereto dated as of August 26, 1987 (Exhibit 10.14) <sup>15</sup>
10.12	Letter of Agreement regarding CPI adjustment dates for leases of premises at Buildings C, E and F at Aquatic Park Center, Berkeley, California dated as of July 22, 1987 (Exhibit 10.15) <sup>15</sup>
10.13	Lease of premises at 2910 Seventh Street, Berkeley, California dated March 25, 1992 (Exhibit 10.16) <sup>5</sup>
10.13A	Fifth amendment to lease of premises at 2910 Seventh Street, Berkeley, California dated June 1, 2006 (Exhibit 10.58) <sup>6</sup>
10.14	Lease of premises at 5860 and 5864 Hollis Street, Emeryville, California dated as of November 2, 2001 (with addendum) (Exhibit 10.19) <sup>7</sup>
10.15	Lease of premises at 2850 Seventh Street, Second Floor, Berkeley, California dated as of December 28, 2001 (with addendum and guaranty) (Exhibit 10.20) <sup>7</sup>
10.16	Amended and Restated Research and License Agreement dated September 1, 1993, between the Company and New York University (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.28) <sup>15</sup>
10.16A	Third Amendment to License Agreement dated June 12, 1997, between the Company and New York University (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.28A) <sup>15</sup>
10.16B	Fourth Amendment to License Agreement dated December 23, 1998, between the Company and New York University (Exhibit 10.22B) <sup>8</sup>

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<u>Exhibit Number</u>	
10.16C	Fifth Amendment to License Agreement dated June 25, 1999, between the Company and New York University (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.21C) <sup>19</sup>
10.16D	Sixth Amendment to License Agreement dated January 25, 2000, between the Company and New York University (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.1) <sup>20</sup>
10.16E	Seventh Amendment to License Agreement by and among New York University, XOMA Technology Limited and XOMA Ireland Limited effective as of November 10, 2004 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 3) <sup>21</sup>
10.17	Second Amended and Restated Collaboration Agreement dated January 12, 2005, by and between XOMA (US) LLC and Genentech, Inc. (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) <sup>10</sup>
10.17A	Agreement related to LUCENTIS® License Agreement and RAPTIVA® Collaboration Agreement dated September 9, 2009, by and between XOMA (Bermuda) Ltd., XOMA (US) LLC and Genentech, Inc. (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.18A) <sup>22</sup>
10.18	License Agreement by and between XOMA Ireland Limited and MorphoSys AG, dated as of February 1, 2002 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.43) <sup>23</sup>
10.19	Amended and Restated License Agreement by and between XOMA Ireland Limited and DYAX Corp., dated as of October 27, 2006 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.32) <sup>14</sup>
10.20	License Agreement by and between XOMA Ireland Limited and Cambridge Antibody Technology Limited, dated as of December 22, 2002 (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.46) <sup>3</sup>
10.21	License Agreement, dated as of December 29, 2003, by and between Diversa Corporation and XOMA Ireland Limited (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 2) <sup>24</sup>
10.22	Agreement, dated February 27, 2004, by and between Chiron Corporation and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.50) <sup>25</sup>
10.22A	Research, Development and Commercialization Agreement, dated as of May 26, 2005, by and between Chiron Corporation and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.2) <sup>26</sup>

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<u>Exhibit Number</u>	
10.22B	Secured Note Agreement, dated as of May 26, 2005, by and between Chiron Corporation and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.3) <sup>26</sup>
10.22C	Amended and Restated Agreement Research, Development and Commercialization Agreement, executed November 7, 2008, by and between Novartis Vaccines and Diagnostics, Inc. (formerly Chiron Corporation) and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) <sup>13</sup>
10.22D	Manufacturing and Technology Transfer Agreement, executed December 16, 2008, by and between Novartis Vaccines and Diagnostics, Inc. (formerly Chiron Corporation) and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) <sup>13</sup>
10.23	Collaboration Agreement, dated as of September 23, 2004, by and between Apton Corporation and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 2) <sup>27</sup>
10.24	Agreement dated March 8, 2005, between XOMA (US) LLC and the National Institute of Allergy and Infectious Diseases (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.53) <sup>10</sup>
10.24A	Agreement dated July 28, 2006, between XOMA (US) LLC and the National Institute of Allergy and Infectious Diseases (Exhibit 10.60) <sup>6</sup>
10.24B	Agreement dated September 15, 2008, between XOMA (US) LLC and the National Institute of Allergy and Infectious Diseases (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.39) <sup>28</sup>
10.25	License Agreement, effective as of June 20, 2005, by and between Merck & Co., Inc. and XOMA Ireland Limited (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.4) <sup>26</sup>
10.26	Form of Dealer Manager Agreement relating to the Company's 6.50% Convertible SNAPs <sub>SM</sub> due February 1, 2012 (Exhibit 1.1) <sup>29</sup>
10.26A	Form of Placement Agreement relating to the Company's 6.50% Convertible SNAPs <sub>SM</sub> due February 1, 2012 (Exhibit 1.2) <sup>29</sup>
10.27	Collaboration Agreement dated as of May 22, 2006, by and between Schering Corporation, acting through its Schering-Plough Research Institute division, and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.59) <sup>16</sup>
10.28	Collaboration Agreement, dated as of November 1, 2006, between Takeda Pharmaceutical Company Limited and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.46) <sup>14</sup>

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<u>Exhibit Number</u>	
10.28A	First Amendment to Collaboration Agreement, effective as of February 28, 2007, between Takeda Pharmaceutical Company Limited and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.48) <sup>30</sup>
10.28B	Second Amendment to Collaboration Agreement, effective as of February 9, 2009, among Takeda Pharmaceutical Company Limited and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) <sup>13</sup>
10.29	Loan Agreement, dated as of November 9, 2006, between Goldman Sachs Specialty Lending Holdings, Inc., XOMA (US) LLC and XOMA Ltd. (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.47) <sup>14</sup>
10.29A	Amended & Restated Loan Agreement, dated as of May 9, 2008 between Goldman Sachs Specialty Lending Holdings, Inc., XOMA Ltd. and XOMA (US) LLC (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.37) <sup>31</sup>
10.30	License Agreement, effective as of August 27, 2007, by and between Pfizer Inc. and XOMA Ireland Limited (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 2) <sup>32</sup>
10.31	Common Stock Purchase Agreement, dated as of October 21, 2008, by and between XOMA Ltd. and Azimuth Opportunity Ltd. (Exhibit 10.1) <sup>3</sup>
10.32	Securities Purchase Agreement dated May 15, 2009, between XOMA Ltd. and the investors named therein (Exhibit 10.1) <sup>3</sup>
10.32A	Engagement Letter dated May 15, 2009 (Exhibit 10.3) <sup>3</sup>
10.33	Securities Purchase Agreement dated June 5, 2009, between XOMA Ltd. and the investors named therein (Exhibit 10.1) <sup>3</sup>
10.33A	Engagement Letter dated June 4, 2009 (Exhibit 10.3) <sup>7</sup>
10.34	Discovery Collaboration Agreement dated September 9, 2009, by and between XOMA Development Corporation and Arana Therapeutics Limited (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission) (Exhibit 10.35) <sup>34</sup>
10.35	At Market Issuance Sales Agreement dated July 14, 2009, by and between XOMA Ltd. and Wm Smith & Co. (Exhibit 10.36) <sup>2</sup>
10.36	Discovery Collaboration Agreement dated October 29, 2009, by and between XOMA Development Corporation and The Chemo-Sero-Therapeutic Research Institute (with certain confidential information omitted, which omitted information is the subject of a confidential treatment request and has been filed separately with the Securities and Exchange Commission)*
10.37	Warrant Amendment Agreement dated February 2, 2010 (May 2009 Warrants) (Exhibit 10.3)
10.37A	Form of Warrant Amendment Agreement dated February 2, 2010 (June 2009 Warrants) (Exhibit 10.4)
21.1	Subsidiaries of the Company*

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<u>Exhibit Number</u>	
23.1	Consent of Independent Registered Public Accounting Firm*
31.1	Certification of Steven B. Engle, filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
31.2	Certification of Fred Kurland, filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002*
32.1	Certification of Steven B. Engle, furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
32.2	Certification of Fred Kurland, furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
99.1	Press Release dated March 11, 2010 furnished herewith

### Footnotes:

- \* Filed herewith.
- 1 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed February 2, 2010.
- 2 Incorporated by reference to the referenced exhibit to the Company's Registration Statement on Form S-4 filed November 27, 1998, as amended.
- 3 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2002.
- 4 Incorporated by reference to the referenced exhibit to the Company's Amendment No. 1 to Form 8-K/A filed April 18, 2003.
- 5 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed February 13, 2006.
- 6 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed May 19, 2009.
- 7 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed June 10, 2009.
- 8 Incorporated by reference to the referenced exhibit to the Company's Registration Statement on Form S-8 filed August 28, 2003.
- 9 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2007, as amended.
- 10 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2004.
- 11 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed November 6, 2007.
- 12 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed August 7, 2007.
- 13 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008.
- 14 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006.
- 15 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1997, as amended.
- 16 Incorporated by reference to the referenced exhibit to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006.
- 17 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2001.
- 18 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1998.
- 19 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1999.

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- 20 Incorporated by reference to the referenced exhibit to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2000.
- 21 Incorporated by reference to the referenced exhibit to the Company's Amendment No. 1 on Form 8-K/A filed November 30, 2004.
- 22 Incorporated by reference to the referenced exhibit to the Company's Quarterly Report on Form 10-Q filed November 9, 2009.
- 23 Incorporated by reference to the referenced exhibit to Amendment No. 2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2002 filed on December 12, 2002.
- 24 Incorporated by reference to the referenced exhibit to the Company's Amendment No. 2 on Form 8-K/A filed March 19, 2004.
- 25 Incorporated by reference to the referenced exhibit to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2003.
- 26 Incorporated by reference to the referenced exhibit to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2005.
- 27 Incorporated by reference to the referenced exhibit to the Company's Amendment No. 1 on Form 8-K/A filed October 26, 2004.
- 28 Incorporated by reference to the referenced exhibit to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2008.
- 29 Incorporated by reference to the referenced exhibit to Amendment No. 2 to the Company's Registration Statement on Form S-4 filed January 11, 2006.
- 30 Incorporated by reference to the referenced exhibit to Amendment No. 1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2007 filed on March 5, 2010.
- 31 Incorporated by reference to the referenced exhibit to Amendment No. 2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2008 filed on March 5, 2010.
- 32 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed September 13, 2007.
- 33 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed October 22, 2008.
- 34 Incorporated by reference to the referenced exhibit to Amendment No. 1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2009 filed on March 5, 2010.
- 35 Incorporated by reference to the referenced exhibit to the Company's Current Report on Form 8-K filed July 16, 1998.

13 November 2009

XOMA Ltd.  
Clarendon House  
2 Church Street  
Hamilton HM 11  
Bermuda

Dear Sirs

**XOMA Ltd. (the “Company”)**

We have acted as special legal counsel in Bermuda to the Company in connection with the sale of up to 25,000,000 common shares, par value US\$0.0005 each (the “Common Shares”) pursuant to a registration statement on form S-3 filed with the U.S. Securities and Exchange Commission (the “Commission”) on 26 December 2007 (as amended by Amendment No. 1 thereto filed with the Commission on 20 May 2008) (such registration statement as so amended herein after referred to as the “Shelf Registration Statement”, which term does not include any other document or agreement whether or not specifically referred to therein or attached as an exhibit or schedule thereto) relating to the shelf registration under the U.S. Securities Act of 1933, as amended, (the “Securities Act”) of common shares, par value US\$0.0005 each, preference shares, par value US\$0.05 each, senior debt securities, subordinated debt securities and warrants of the Company and a supplemental prospectus forming part of the Shelf Registration Statement dated and filed with the Commission on 9 November 2009 (the “Prospectus Supplement”, together with the Shelf Registration Statement, the “Registration Statement”).

For the purposes of giving this opinion, we have examined a PDF copy of the Registration Statement.

We have also reviewed the memorandum of continuance and the bye-laws of the Company (together, the “Constitutional Documents”), each certified by the Secretary of the Company on 12 November 2009, certified resolutions passed at meetings of the Company’s directors held on 1 May 2009 and certified resolutions passed at meetings of the Company’s shareholders held on 21 May 2009, (together, the “Resolutions”) and such other documents and made such enquiries as to questions of law as we have deemed necessary in order to render the opinion set forth below.

We have assumed (a) the genuineness and authenticity of all signatures and the conformity to the originals of all copies (whether or not certified) examined by us and the authenticity and completeness of the originals from which such copies were taken; (b) that where a document has been examined by us in draft form, it will be or has been executed and/or filed in the form of that draft, and where a number of drafts of a document have been examined by us all changes thereto

have been marked or otherwise drawn to our attention; (c) the accuracy and completeness of all factual representations made in the Registration Statement and the other documents reviewed by us; (d) that the resolutions contained in the Resolutions were passed at duly convened, constituted and quorate meetings and remain in full force and effect and have not been rescinded or amended; (e) that the Constitutional Documents will not be amended in any manner that would affect the opinions expressed herein, (f) that there is no provision of the law of any jurisdiction, other than Bermuda, which would have any implication in relation to the opinions expressed herein; (g) the Company will have sufficient authorised but unissued capital to effect the issue of any of the Common Shares at the time of issuance; (h) that at all material times the Company's shares will be listed on an appointed stock exchange, as defined in the Companies Act 1981, as amended, and the consent to the issue and free transfer of the Common Shares given by the Bermuda Monetary Authority as of 8 February 2000 will not have been revoked or amended at the time of issuance of any Common Shares; (i) that, upon issue of the Common Shares, the Company will receive consideration for the full issue price thereof which shall be equal to at least the par value thereof; (j) that the Company will comply, to the extent applicable, with the requirements of Part III of the Companies Act entitled "Prospectus and Public Offers"; (k) the capacity, power and authority of each of the parties, other than the Company, to enter into and perform its respective obligations under any and all documents entered into by such parties in connection with the issuance of the Common Shares; and (l) that none of the parties to any and all documents entered into by such parties in connection with the issuance of the Common Shares, carries on business from premises in Bermuda, at which it employs staff and pays salaries and other expenses.

"Non-assessability" is not a legal concept under Bermuda law, but when we describe the Common Shares herein as being "non-assessable" we mean, subject to any contrary provision in any agreement between the Company and any one of its members holding any of the Common Shares (but only with respect to such member), that no further sums are payable with respect to the issue of such shares and no member shall be bound by an alteration in the Constitutional Documents after the date upon which it became a member if and so far as the alteration requires such member to take or subscribe for additional Common Shares or in any way increases its liability to contribute to the share capital of, or otherwise pay money to, the Company.

We have made no investigation of and express no opinion in relation to the laws of any jurisdiction other than Bermuda. This opinion is to be governed by and construed in accordance with the laws of Bermuda and is limited to and is given on the basis of the current law and practice in Bermuda. This opinion is issued solely for the purposes of the filing of the Registration Statement and the issuance of the Common Shares by the Company as described in the Registration Statement and is not to be relied upon in respect of any other matter.

On the basis of and subject to the foregoing, we are of the opinion that:

1. The Company has been duly continued to Bermuda and is existing under the laws of Bermuda in good standing (meaning solely that it has not failed to make any filing with any Bermuda governmental authority, or to pay any Bermuda government fee or tax, which would make it liable to be struck off the Register of Companies and thereby cease to exist under the laws of Bermuda).
2. When issued and paid for as contemplated by the Registration Statement, the Common Shares will be validly issued, fully paid and non-assessable and will constitute valid and binding obligations of the Company in accordance with the terms thereof.

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We hereby consent to the filing of this opinion as an exhibit to the Registration Statement and to the references to our firm under the caption "Legal Matters" in the prospectus forming a part of the Registration Statement. In giving such consent, we do not hereby admit that we are experts within the meaning of Section 11 of the Securities Act or that we are in the category of persons whose consent is required under Section 7 of the Securities Act or the Rules and Regulations of the Commission promulgated thereunder.

Yours faithfully

**/s/ Conyers Dill & Pearman**

**FORM OF  
AMENDED AND RESTATED  
EMPLOYMENT AGREEMENT**

This Amended and Restated Employment Agreement ("Agreement"), effective as of this 30th day of December, 2008, by and between XOMA (US) LLC ("XOMA" or the "Company"), a Delaware limited liability company with its principal office at 2910 Seventh Street, Berkeley, California, and \_\_\_\_\_ ("Employee"), an individual residing at \_\_\_\_\_.

WHEREAS, the Company and Employee entered into an Employment Agreement effective as of \_\_\_\_\_, 200\_ (the "Original Agreement") to assure the Company of the continued services of Employee;

WHEREAS, the Company wishes to enter into this Agreement to amend and restate the Original Agreement; and

WHEREAS, Employee is willing to enter into this Agreement and to continue to serve in the employ of the Company upon the terms and conditions hereinafter provided;

NOW, THEREFORE, in consideration of the mutual covenants herein contained, the parties hereto hereby agree as follows:

1. Employment. The Company agrees to continue to employ Employee, and Employee agrees to continue to be employed by the Company, for the period referred to in Section 3 hereof and upon the other terms and conditions herein provided.

2. Position and Responsibilities. The Company agrees to employ Employee in the position of \_\_\_\_\_, and Employee agrees to serve as \_\_\_\_\_, for the term and on the conditions hereinafter set forth. Employee agrees to perform such services not inconsistent with her/his position as shall from time to time be assigned to her/him by the Chairman of the Board, President and Chief Executive Officer of the Company (the "Chairman").

3. Term and Duties.

(a) Term of Employment. This Agreement shall become effective and the term of employment pursuant to this Agreement shall commence on \_\_\_\_\_, 2006 and will continue until \_\_\_\_\_, \_\_\_\_\_. and will be automatically extended (without further action by the parties) for one year thereafter and again on each subsequent anniversary thereof unless notice of nonextension of the term is given by either the Employee or the Company more than 90 days prior to the next scheduled expiration date or unless Employee's employment is terminated by the Company or he/she resigns from the Company's employ as described herein.

(b) Duties. During the period of her/his employment hereunder Employee shall serve the Company as its \_\_\_\_\_, and except for illnesses, vacation periods and reasonable leaves of absence, Employee shall devote all of her/his business time, attention, skill and efforts to the faithful performance of her/his duties hereunder. So long as Employee is \_\_\_\_\_ of the Company, he/she will discharge all duties incidental to such office and such further duties as may be reasonably assigned to her/him from time to time by the Chairman.

4. Compensation and Reimbursement of Expenses.

(a) Compensation. For all services rendered by Employee as \_\_\_\_\_ during her/his employment under this Agreement, the Company shall pay Employee as compensation a base salary at a rate of not less than \$\_\_\_\_per annum. All taxes and governmentally required withholding shall be deducted in conformity with applicable laws.

(b) Reimbursement of Expenses. The Company shall pay or reimburse Employee for all reasonable travel and other expenses incurred by Employee in performing her/his obligations under this Agreement in a manner consistent with past Company practice. The Company further agrees to furnish Employee with such assistance and accommodations as shall be suitable to the character of Employee's position with the Company, adequate for the performance of her/his duties and consistent with past Company practice.

5. Participation in Benefit Plans. The payments provided in Section 4 hereof are in addition to benefits Employee is entitled to under any group hospitalization, health, dental care, disability insurance, surety bond, death benefit plan, travel and/or accident insurance, other allowance and/or executive compensation plan, including, without limitation, any senior staff incentive plan, capital accumulation programs, restricted or non-restricted share purchase plan, share option plan, retirement income or pension plan or other present or future group employee benefit plan or program of the Company for which key executives are or shall become eligible, and Employee shall be eligible to receive during the period of her/his employment under this Agreement, all benefits and emoluments for which key executives are eligible under every such plan or program to the extent permissible under the general terms and provisions of such plans or programs and in accordance with the provisions thereof.

6. Payments to Employee Upon Termination of Employment.

(a) Termination. Upon the occurrence of an event of termination (as hereinafter defined) during the period of Employee's employment under this Agreement, the provisions of this paragraph 6(a) and paragraph 6(b) shall apply. As used in this Agreement, an "event of termination" shall mean and include any one or more of the following:

(i) The termination by the Company of Employee's employment hereunder for any reason other than pursuant to paragraph 6(c) and shall include any termination of the Employee's employment upon expiration of the term of this Agreement due to the Company giving written notice of its intention not to extend the term of this Agreement as provided in paragraph 3(a); or

(ii) Employee's resignation from the Company's employ for Good Reason in accordance with the terms hereof. "Good Reason" shall mean, unless remedied by the Company within thirty (30) days after the receipt of written notice from the Employee as provided below or consented to in writing by the Employee, (A) the material diminution of any material duties or responsibilities of the Employee; or (B) a material reduction in the Employee's base salary; provided, however, that the Employee must have given written notice to the Company of the existence of any such condition within ninety (90) days after the initial existence thereof (and the failure to provide such timely notice will constitute a waiver of the Employee's ability to terminate employment for Good Reason as a result of such condition), and the Company will have a period of thirty (30) days from receipt of such written notice during which it may remedy the condition; provided further, however, that any termination of employment by the Employee for Good Reason must occur not later than one hundred eighty (180) days following the initial existence of the condition giving rise to such Good Reason.

6(a). (b) Severance Pay and Other Benefits. The following provisions of this Section 6(b) shall apply upon the occurrence of an event of termination under paragraph

(i) Cash Severance Pay. Upon the occurrence of an event of termination under paragraph 6(a), the Company shall, subject to the provisions of Section 7 below, pay Employee, or in the event of her/his subsequent death, her/his beneficiary or beneficiaries of her/his estate, as the case may be, as severance pay or liquidated damages, or both, (A) a severance payment in an amount equal to \_\_\_\_times the Employee's annual base salary as in effect immediately prior to the termination, and (B) a severance payment equal to the sum of (1) \_\_\_\_times the Employee's annual target bonus as in effect for the fiscal year in which the termination occurs, and (2) an amount equal to a pro-rated portion of the Employee's annual target bonus as in effect for the fiscal year in which the termination occurs calculated by multiplying the annual target bonus by a fraction, the numerator of which shall be the number of calendar months (including a portion of any such month) that the Employee was employed with the Company prior to the occurrence of the termination during such fiscal year, and the denominator of which shall be 12. Such severance payments shall be in lieu of any other severance payment to which the Employee shall be entitled as a result of such termination pursuant to this Agreement, any other employment agreement with or offer letter from the Company or any of its affiliates or the Company's or any of its affiliate's then existing severance plans and policies, except in those circumstances where the provisions of the Amended and Restated Change of Control Severance Agreement, effective as of \_\_\_\_\_, 200 \_\_, between Employee and XOMA Ltd., by such agreement's express terms, apply, in which case the provisions of such agreement providing for severance payment(s) to Employee as a result of such termination shall apply in lieu of the provisions of this Agreement relating thereto. The severance payment described in Section 6(b)(i)(A) shall be paid in

monthly installments over [ ] months (the "Severance Payment Period"), with the first two (2) of such monthly installments being paid sixty (60) days after the date of termination and the remaining monthly installments being paid monthly thereafter until fully paid, and the severance payments described in Section 6(b)(i) (B) shall be paid in a lump sum sixty (60) days after the date of termination; provided, however, that all of such severance payments shall be subject to the requirements of Section 6(b)(iii) and Section 6(b)(v) below.

(ii) Group Health Coverage and Certain Other Benefits. In addition, during a period of \_\_\_\_ months following an event of termination under paragraph 6(a), (A) the Company shall pay for the full cost of the coverage (plus an additional amount to pay for the taxes on such payments, if any, plus any taxes on such additional amount, such amount to be paid no later than ten (10) days prior to the date such taxes are due) of the Employee and Employee's spouse and eligible dependents under any group health plans of the Company on the date of such termination of employment at the same level of health (i.e., medical, vision and dental) coverage and benefits as in effect for the Employee or such covered dependents on the date immediately preceding the date of the Employee's termination; provided, however, that (1) the Employee and Employee's spouse and eligible dependents each constitutes a qualified beneficiary, as defined in Section 4980B(g) (1) of the Internal Revenue Code of 1986, as amended (the "Code"); and (2) the Employee elects continuation coverage pursuant to the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended ("COBRA"), within the time period prescribed pursuant to COBRA; and (B) if Employee is, at the time of such termination, an eligible participant in the Company's mortgage differential program, the Company shall continue to make mortgage assistance payments to Employee pursuant to such program as in effect at the time of such termination. Notwithstanding the foregoing, the payments by the Company for such group health coverage and/or mortgage assistance, as applicable, shall cease prior to the expiration of the \_\_\_\_ month period in this Section 6(b)(ii) upon the employment of the Employee by another employer. Furthermore, if, at the time of the termination of Employee's employment under paragraph 6(a), Employee is the obligor of a "forgivable" loan (i.e., a loan which by its terms is to be considered forgiven by the Company and paid by the obligor in circumstances other than actual repayment) from the Company, then, notwithstanding any provisions of such loan to the contrary, such loan shall remain outstanding, and the forgiveness thereof shall continue, for a period of \_\_\_\_ months following such termination in accordance with the terms of such loan in effect at the time of such termination provided, however, that at the end of such period of \_\_\_\_ months, the outstanding balance of such loan shall be immediately due and payable, together with any accrued and unpaid interest thereon.

(iii) Section 409A of the Code. Notwithstanding any provision to the contrary in this Agreement, if the Employee is deemed on the date of his or her "separation from service" (within the meaning of Treas. Reg. Section 1.409A-1(h)) with the Company to be a "specified employee" (within the meaning of Treas. Reg. Section 1.409A-1(i)), then with regard to any payment or benefit (including,

without limitation, any mortgage assistance payment or loan forgiveness referred to above) that is considered deferred compensation under Section 409A payable on account of a "separation from service" that is required to be delayed pursuant to Section 409A(a)(2)(B) of the Code (after taking into account any applicable exceptions to such requirement), such payment or benefit shall be made or provided on the date that is the earlier of (i) the expiration of the six (6)-month period measured from the date of the Employee's "separation from service," or (ii) the date of the Employee's death (the "Delay Period"). Upon the expiration of the Delay Period, all payments and benefits delayed pursuant to this Section 9(c) (whether they would have otherwise been payable in a single sum or in installments in the absence of such delay) shall be paid or reimbursed to the Employee in a lump sum and any remaining payments and benefits due under this Agreement shall be paid or provided in accordance with the normal payment dates specified for them herein. Notwithstanding any provision of this Agreement to the contrary, for purposes of any provision of this Agreement providing for the payment of any amounts or benefits upon or following a termination of employment, references to the Employee's "termination of employment" (and corollary terms) with the Company shall be construed to refer to Employee's "separation from service" (within the meaning of Treas. Reg. Section 1.409A-1(h)) with the Company.

(iv) Outplacement Program. Upon the occurrence of an event of termination under paragraph 6(a), the Employee will immediately become entitled to participate in a \_\_\_\_\_ month executive outplacement program provided by an executive outplacement service, at the Company's expense not to exceed\_\_\_\_\_.

(v) Release of Claims. As a condition of entering into this Agreement and receiving the severance benefits under this Section 6(b), the Employee agrees to execute, on or before the date that is fifty (50) days following the date of termination, and not revoke a release of claims agreement substantially in the form attached hereto as Exhibit A upon the termination of the Employee's employment with the Company. Such release shall not, however, apply to the rights and claims of the Employee under this Agreement, any indemnification agreement between the Employee and XOMA Ltd. (or its successor or acquirer), the bye-laws of XOMA Ltd. (or its successor or acquirer), the share award agreements between the Employee and XOMA Ltd. (or its successor or acquirer), or any employee benefit plan of which the Employee is a participant and under which all benefits due under such plan have not yet been paid or provided.

(c) Other Termination of Employment. Notwithstanding paragraphs 6(a) and (b) or any other provision of this Agreement to the contrary, if on or after the date of this Agreement and prior to the end of the term hereof:

(i) Employee has been convicted of any crime or offense constituting a felony under applicable law, including, without limitation, any act of dishonesty such as embezzlement, theft or larceny;

(ii) Employee shall act or refrain from acting in respect of any of the duties and responsibilities which have been assigned to her/him in accordance with this Agreement and shall fail to desist from such action or inaction within thirty (30) days after Employee's receipt of notice from the Company of such action or inaction and the Board of Directors determines that such action or inaction constituted gross negligence or a willful act of malfeasance or misfeasance of Employee in respect of such duties; or

(iii) Employee shall breach any material term of this Agreement and shall fail to correct such breach within thirty (30) days after Employee's receipt of notice from the Company of such breach (provided such breach can be cured);

then, and in each such case, the Company shall have the right to give notice of termination of Employee's services hereunder (or pay Employee in lieu of notice) as of a date (not earlier than fourteen (14) days from such notice) to be specified in such notice and this Agreement (other than the provisions of Section 7 hereof) shall terminate on such date.

7. Post-Termination Obligations. All payments and benefits to Employee under this Agreement shall be subject to Employee's compliance with the following provisions during the term of her/his employment and for the Severance Payment Period:

(a) Confidential Information and Competitive Conduct. Employee shall not, to the detriment of the Company, disclose or reveal to any unauthorized person any trade secret or other confidential information relating to the Company or its affiliates or to any businesses operated by them, and Employee confirms that such information constitutes the exclusive property of the Company. Employee shall not otherwise act or conduct her/himself to the material detriment of the Company or its affiliates, or in a manner which is inimical or contrary to the interests thereof, and, for a period of twelve (12) months following an event of termination under paragraph 6(a), shall not, directly or indirectly, engage in or render any service (whether to a person, firm or business) in direct competition with the Company; provided, however, that Employee's ownership of less than five percent (5%) of the outstanding stock of a corporation shall not be itself be deemed to constitute such competition. Employee recognizes that the possible restrictions on her/his activities which may occur as a result of her/his performance of her/his obligations under this paragraph 7(a) are required for the reasonable protection of the Company and its investments. For purposes hereof, "in direct competition" means engaged in the research, development and/or production of biological materials intended for use as therapeutic, prophylactic or diagnostic products in one or more of the same indications, and that utilize one or more of the same scientific bases (e.g., in the case of a therapeutic antibody, targets the same signal initiating pathway), as a product or product candidate the research, development and/or production of which is an active part of the Company's business plan at the time of Employee's termination.

(b) Non-Disparagement. The Employee and the Company agree to refrain from any defamation, libel or slander of the other and its respective officers, directors, employees, representatives, investors, shareholders, administrators, affiliates, divisions,

subsidiaries, predecessor and successor corporations and assigns or tortious interference with the contracts and relationships of the other and its respective officers, directors, employees, representatives, investors, shareholders, administrators, affiliates, divisions, subsidiaries, predecessor and successor corporations and assigns.

(c) Failure of Employee to Comply. If, for any reason other than death or disability, Employee shall, without written consent of the Company, fail to comply with the provisions of paragraphs 7(a) or 7(b) above, her/his rights to any future payments or other benefits hereunder shall terminate, and the Company's obligations to make such payments and provide such benefits shall cease.

(d) Remedies. Employee agrees that monetary damages would not be adequate compensation for any loss incurred by the Company by reason of a breach of the provisions of this Section 7 and hereby agrees to waive the defense in any action for specific performance that a remedy at law would be adequate.

8. Effect of Prior Agreements. This Agreement contains the entire understanding between the parties hereto and supersedes any prior employment agreements between the Company and Employee, but shall not supersede the Change of Control Severance Agreement referred to above, any indemnification agreement between the Employee and XOMA Ltd. (or its successor or acquirer), the share award agreements between the Employee and XOMA Ltd. (or its successor or acquirer), or any employee benefit plan of which the Employee is a participant and under which all benefits due under such plan have not yet been paid or provided.

#### 9. General Provisions.

(a) Binding Agreement. This Agreement shall be binding upon, and inure to the benefit of, Employee and the Company and their respective permitted successors and assigns.

(b) Legal Expenses. In the event that Employee incurs legal expenses in contesting any provision of this Agreement and such contest results in a determination that the Company has breached any of its obligations hereunder, Employee shall be reimbursed by the Company for such legal expenses.

#### (c) Compliance with Section 409A of the Code.

(i) It is intended that this Agreement will comply with Section 409A of the Code and any regulations and guidelines promulgated thereunder (collectively, "Section 409A"), to the extent the Agreement is subject thereto, and the Agreement shall be interpreted on a basis consistent with such intent. If an amendment of the Agreement is necessary in order for it to comply with Section 409A of the Code, the parties hereto will negotiate in good faith to amend the Agreement in a manner that preserves the original intent of the parties to the extent reasonably possible. No action or failure to act pursuant to this Section 9(c) shall subject the Company to any claim, liability, or expense, and the Company shall not have any obligation to indemnify or otherwise protect the Employee from the obligation to pay any taxes, interest or penalties pursuant to Section 409A of the Code.

(ii) With respect to any reimbursement or in-kind benefit arrangements of the Company and its subsidiaries that constitute deferred compensation for purposes of Section 409A, except as otherwise permitted by Section 409A, the following conditions shall be applicable: (A) the amount eligible for reimbursement, or in-kind benefits provided, under any such arrangement in one calendar year may not affect the amount eligible for reimbursement, or in-kind benefits to be provided, under such arrangement in any other calendar year (except that the health and dental plans may impose a limit on the amount that may be reimbursed or paid), (B) any reimbursement must be made on or before the last day of the calendar year following the calendar year in which the expense was incurred, and (C) the right to reimbursement or in-kind benefits is not subject to liquidation or exchange for another benefit. Whenever a payment under this Agreement specifies a payment period with reference to a number of days (e.g., "payment shall be made within thirty (30) days after termination of employment"), the actual date of payment within the specified period shall be within the sole discretion of the Company. Whenever payments under this Agreement are to be made in installments, each such installment shall be deemed to be a separate payment for purposes of Section 409A.

10. Successors and Assigns.

(a) Assignment by the Company. This Agreement shall be binding upon and inure to the benefit of the successors and assigns of the Company and, unless clearly inapplicable, reference herein to the Company shall be deemed to include its successors and assigns.

(b) Assignment by Employee. Employee may not assign this Agreement in whole or in part.

11. Modification and Waiver.

(a) Amendment of Agreement. This Agreement may not be modified or amended except by an instrument in writing signed by the parties hereto.

(b) Waiver. No term or condition of this Agreement shall be deemed to have been waived except by written instrument of the party charged with such waiver. No such written waiver shall be deemed a continuing waiver unless specifically stated therein, and each such waiver shall operate only as to the specific term or condition waived.

12. Severability. In the event any provision of this Agreement or any part hereof is held invalid, such invalidity shall not affect any remaining part of such provision or any other provision. If any court construes any provision of this Agreement to be illegal, void or unenforceable because of the duration or the area or matter covered thereby, such court shall reduce the duration, area or matter of such provision, and, in its reduced form, such provision shall then be enforceable and shall be enforced.

13. Governing Law. This Agreement has been executed and delivered in the State of California, and its validity interpretation, performance, and enforcement shall be governed by the laws of said State.

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IN WITNESS WHEREOF, XOMA has caused this Agreement to be executed by its duly authorized officer, and Employee has signed this Agreement, all as of the day and year first above written.

XOMA (US) LLC

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By: Steven Engle  
Chairman of the Board, Chief Executive Officer and President

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Employee

**EXHIBIT A**

**FORM RELEASE OF CLAIMS AGREEMENT**

This Release of Claims Agreement (this "Agreement") is made and entered into by and between XOMA (US) LLC (the "Company") and \_\_\_\_\_ (the "Employee").

WHEREAS, the Employee was employed by the Company; and

WHEREAS, the Company and the Employee have entered into an employment agreement effective as of \_\_\_\_\_, 200\_ (the "Employment Agreement").

NOW THEREFORE, in consideration of the mutual promises made herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Company and the Employee (collectively referred to as the "Parties") desiring to be legally bound do hereby agree as follows:

1. Termination. The Employee's employment with the Company terminated on \_\_\_\_\_, 20\_\_.

2. Consideration. Subject to and in consideration of the Employee's release of claims as provided herein, the Company has agreed to pay the Employee certain benefits and the Employee has agreed to provide certain benefits to the Company, both as set forth in the Employment Agreement.

3. Release of Claims. The Employee agrees that the foregoing consideration represents settlement in full of all currently outstanding obligations owed to the Employee by the Company. The Employee, on the Employee's own behalf and the Employee's respective heirs, family members, executors and assigns, hereby fully and forever releases the Company and its past, present and future officers, agents, directors, employees, investors, shareholders, administrators, affiliates, divisions, subsidiaries, parents, predecessor and successor corporations, and assigns, from, and agrees not to sue or otherwise institute or cause to be instituted any legal or administrative proceedings concerning any claim, duty, obligation or cause of action relating to any matters of any kind, whether presently known or unknown, suspected or unsuspected, that the Employee may possess arising from any omissions, acts or facts that have occurred up until and including the Effective Date (as defined below) of this Agreement including, without limitation:

(a) any and all claims relating to or arising from the Employee's employment relationship with the Company and the termination of that relationship;

(b) any and all claims relating to, or arising from, the Employee's right to purchase, or actual purchase of shares of stock of the Company, including, without limitation, any claims for fraud, misrepresentation, breach of fiduciary duty, breach of duty under applicable state corporate law and securities fraud under any state or federal law;

(c) any and all claims for wrongful discharge of employment, termination in violation of public policy, discrimination, breach of contract (both express and implied), breach of a covenant of good faith and fair dealing (both express and implied), promissory estoppel, negligent

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or intentional infliction of emotional distress, negligent or intentional misrepresentation, negligent or intentional interference with contract or prospective economic advantage, unfair business practices, defamation, libel, slander, negligence, personal injury, assault, battery, invasion of privacy, false imprisonment and conversion;

(d) any and all claims for violation of any federal, state or municipal statute, including, but not limited to, Title VII of the Civil Rights Act of 1964, the Civil Rights Act of 1991, the Age Discrimination in Employment Act of 1967, the Americans with Disabilities Act of 1990, the Fair Labor Standards Act, the Employee Retirement Income Security Act of 1974, The Worker Adjustment and Retraining Notification Act, the California Fair Employment and Housing Act, and Labor Code Section 201, *et seq.* and Section 970, *et seq.* and all amendments to each such Act as well as the regulations issued thereunder;

(e) any and all claims for violation of the federal or any state constitution;

(f) any and all claims arising out of any other laws and regulations relating to employment or employment discrimination; and

(g) any and all claims for attorneys' fees and costs.

The Employee agrees that the release set forth in this Section 4 shall be and remain in effect in all respects as a complete general release as to the matters released. Notwithstanding the foregoing, this release does not extend to any obligations now or subsequently incurred under this Agreement, the Employment Agreement, the Indemnification Agreement between the Employee and the Company (or its successor or acquirer), the outstanding stock award agreements between the Employee and the Company (or its successor or acquirer), or any employee benefit plan of which the Employee is a participant and under which all benefits due under such plan have not yet been paid or provided.

4. Acknowledgment of Waiver of Claims under ADEA. The Employee acknowledges that the Employee is waiving and releasing any rights the Employee may have under the Age Discrimination in Employment Act of 1967 ("ADEA") and that this waiver and release is knowing and voluntary. The Employee and the Company agree that this waiver and release does not apply to any rights or claims that may arise under the ADEA after the Effective Date of this Agreement. The Employee acknowledges that the consideration given for this waiver and release agreement is in addition to anything of value to which the Employee was already entitled. The Employee further acknowledges that the Employee has been advised by this writing that (a) the Employee should consult with an attorney prior to executing this Agreement; (b) the Employee has at least twenty-one (21) days within which to consider this Agreement; (c) the Employee has seven (7) days following the execution of this Agreement by the Parties to revoke the Agreement; and (d) this Agreement shall not be effective until the revocation period has expired. Any revocation should be in writing and delivered to the Company by the close of business on the seventh (7<sup>th</sup>) day from the date that the Employee signs this Agreement.

5. Civil Code Section 1542. The Employee represents that the Employee is not aware of any claims against the Company other than the claims that are released by this Agreement. The Employee acknowledges that the Employee has been advised by legal counsel and is familiar with the provisions of California Civil Code Section 1542, which provides as follows:

**A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HER OR HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HER OR HIM MUST HAVE MATERIALLY AFFECTED HER OR HIS SETTLEMENT WITH THE DEBTOR.**

The Employee, being aware of said code section, agrees to expressly waive any rights the Employee may have thereunder, as well as under any other statute or common law principles of similar effect.

6. No Pending or Future Lawsuits. The Employee represents that the Employee has no lawsuits, claims or actions pending in the Employee's name, or on behalf of any other person or entity, against the Company or any other person or entity referred to herein. The Employee also represents that the Employee does not intend to bring any claims on the Employee's own behalf or on behalf of any other person or entity against the Company or any other person or entity referred to herein except, if necessary, with respect to the agreements listed in the last sentence of Section 4 of this Agreement.

7. Confidentiality. The Employee agrees to use the Employee's best efforts to maintain in confidence the existence of this Agreement, the contents and terms of this Agreement, and the consideration for this Agreement (hereinafter collectively referred to as "Release Information"). The Employee agrees to take every reasonable precaution to prevent disclosure of any Release Information to third parties and agrees that there will be no publicity, directly or indirectly, concerning any Release Information. The Employee agrees to take every precaution to disclose Release Information only to those attorneys, accountants, governmental entities and family members who have a reasonable need to know of such Release Information.

8. No Adverse Cooperation. The Employee agrees the Employee will not act in any manner that might damage the business of the Company. The Employee agrees that the Employee will not counsel or assist any attorneys or their clients in the presentation or prosecution of any disputes, differences, grievances, claims, charges or complaints by any third party against the Company and/or any officer, director, employee, agent, representative, shareholder or attorney of the Company, unless compelled under a subpoena or other court order to do so.

9. Costs. The Parties shall each bear their own costs, expert fees, attorneys' fees and other fees incurred in connection with this Agreement.

10. Authority. The Company represents and warrants that the undersigned has the authority to act on behalf of the Company and to bind the Company and all who may claim through it to the terms and conditions of this Agreement. The Employee represents and warrants that the Employee has the capacity to act on the Employee's own behalf and on behalf of all who might claim through the Employee to bind them to the terms and conditions of this Agreement.

11. No Representations. The Employee represents that the Employee has had the opportunity to consult with an attorney, and has carefully read and understands the scope and effect of the provisions of this Agreement. Neither party has relied upon any representations or statements made by the other party hereto which are not specifically set forth in this Agreement.

12. Severability. In the event that any provision hereof becomes or is declared by a court of competent jurisdiction to be illegal, unenforceable or void, this Agreement shall continue in full force and effect without said provision.

13. Entire Agreement. This Agreement and the Employment Agreement and the agreements and plans referenced therein represent the entire agreement and understanding between the Company and the Employee concerning the Employee's separation from the Company, and supersede and replace any and all prior agreements and understandings concerning the Employee's relationship with the Company and the Employee's compensation by the Company. This Agreement may only be amended in writing signed by the Employee and an executive officer of the Company.

14. Governing Law. This Agreement shall be governed by the internal substantive laws, but not the choice of law rules, of the State of California.

15. Effective Date. This Agreement is effective eight (8) days after it has been signed by the Parties (the "Effective Date") unless it is revoked by the Employee within seven (7) days of the execution of this Agreement by the Employee.

16. Counterparts. This Agreement may be executed in counterparts, and each counterpart shall have the same force and effect as an original and shall constitute an effective, binding agreement on the part of each of the undersigned.

17. Voluntary Execution of Agreement. This Agreement is executed voluntarily and without any duress or undue influence on the part or behalf of the Parties hereto, with the full intent of releasing all claims. The Parties acknowledge that:

(a) they have read this Agreement;

(b) they have been represented in the preparation, negotiation and execution of this Agreement by legal counsel of their own choice or that they have voluntarily declined to seek such counsel;

(c) they understand the terms and consequences of this Agreement and of the releases it contains; and

(d) they are fully aware of the legal and binding effect of this Agreement.

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IN WITNESS WHEREOF, the Parties have executed this Agreement on the respective dates set forth below.

**XOMA (US) LLC**

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

Title: \_\_\_\_\_

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

**EMPLOYEE**

\_\_\_\_\_  
Name

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

Terms of Individual Employment Agreements With Named Executive Officers  
(to be read in conjunction with Form of Employment Agreement)

<u>Name (Title)</u>	<u>Paragraph 6(b)(i)</u>		<u>Paragraph 6(b)(ii)</u>	<u>Paragraph 6(b)(iv)</u>	
Steven B. Engle (Chairman of the Board, Chief Executive Officer and President)	1.5	18 months	18 months	12 months	\$ 15,000
Patrick J. Scannon, MD, PhD (Executive Vice President and Chief Medical Officer)	0.75	9 months	9 months	6 months	\$ 8,000
Fred Kurland (Vice President, Finance and Chief Financial Officer)	0.75	9 months	9 months	6 months	\$ 8,000
Christopher J. Margolin (Vice President, General Counsel and Secretary)	0.75	9 months	9 months	6 months	\$ 8,000
Robert S. Tenerowicz (Vice President, Operations)	0.75	9 months	9 months	6 months	\$ 8,000

**FORM OF  
XOMA LTD.  
AMENDED AND RESTATED  
CHANGE OF CONTROL SEVERANCE AGREEMENT**

This Amended and Restated Change of Control Severance Agreement (the "Agreement") is made and entered into effective as of \_\_\_\_\_, 200\_ (the "Effective Date"), by and between \_\_\_\_\_ (the "Employee") and XOMA Ltd., a Bermuda company (the "Company").

RECITALS

A. It is expected that the Company may from time to time consider the possibility of a Change of Control (as hereinafter defined). The Board of Directors of the Company (the "Board") recognizes that such consideration could be a distraction to the Employee and could cause the Employee to consider alternative employment opportunities.

B. The Board believes that it is in the best interest of the Company and its shareholders to provide the Employee with an incentive to continue the Employee's employment and to maximize the value of the Company upon a Change of Control for the benefit of its shareholders.

C. In order to provide the Employee with enhanced financial security and sufficient encouragement to remain with the Company notwithstanding the possibility of a Change of Control, the Company and the Employee entered into a Change of Control Severance Agreement effective as of \_\_\_\_\_, 200\_ (the "Original Agreement") to provide the Employee with certain severance benefits upon the Employee's termination of employment following a Change of Control.

D. The Company and the Employee wish to enter into this Agreement to amend and restate the Original Agreement.

E. XOMA (US) LLC, a wholly-owned subsidiary of the Company, and the Employee have previously entered into an employment agreement effective as of \_\_\_\_\_, 200\_, which has been amended and restated effective as of \_\_\_\_\_, 200\_ (the "Existing Agreement") and provides the Employee with certain severance benefits upon the Employee's termination of employment.

F. The parties intend that this Agreement shall operate in addition to, and not in replacement of, the Existing Agreement.

AGREEMENT

In consideration of the mutual covenants herein contained and the continued employment of the Employee by the Company, the parties agree as follows:

1. Definition of Terms. The following terms referred to in this Agreement shall have the following meanings:

(a) "Cause" shall mean (i) the Employee has been convicted of any crime or offense constituting a felony under applicable law, including, without limitation, any act of dishonesty such as embezzlement, theft or larceny, (ii) the Employee has acted or refrained from acting in respect of any of the duties and responsibilities which have been assigned to her/him in accordance with this Agreement or the Existing Agreement and shall fail to desist from such action or inaction within thirty (30) days after the Employee's receipt of notice from the Company of such action or inaction and the Board determines that such action or inaction constituted gross negligence or a willful act of malfeasance or misfeasance of the Employee in respect of such duties, or (iii) the Employee has breached any material term of this Agreement or the Existing Agreement and shall fail to correct such breach within thirty (30) days after the Employee's receipt of notice from the Company of such breach.

(b) "Change of Control" shall mean the occurrence of any of the following events:

(i) a merger, amalgamation or acquisition in which the Company is not the surviving or continuing entity, except for a transaction the principal purpose of which is to change the jurisdiction of the Company's organization;

(ii) the sale, transfer or other disposition of all or substantially all of the assets of the Company;

(iii) any other reorganization or business combination in which fifty percent (50%) or more of the Company's outstanding voting securities are transferred to different holders in a single transaction or series of related transactions;

(iv) any approval by the shareholders of the Company of a plan of complete liquidation of the Company;

(v) any "person" (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended) becoming the "beneficial owner" (as defined in Rule 13d-3 under said Act), directly or indirectly, of securities of the Company representing more than fifty percent (50%) of the total voting power represented by the Company's then outstanding voting securities; or

(vi) a change in the composition of the Board, as a result of which fewer than a majority of the directors are Incumbent Directors. "Incumbent Directors" shall mean directors who (A) are directors of the Company as of the date hereof, (B) are elected, or nominated for election, to the Board with the affirmative votes of the directors of the Company as

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of the date hereof, or (C) are elected, or nominated for election, to the Board with the affirmative votes of at least a majority of those directors whose election or nomination was not in connection with any transaction described in subsections (i) through (v) or in connection with an actual or threatened proxy contest relating to the election of directors of the Company.

(c) "Change of Control Protection Period" shall mean the period commencing one (1) month prior to the execution of the definitive agreement for a Change of Control and eighteen (18) months following the closing of a Change of Control.

(d) "Compensation Continuation Period" shall mean the period of time commencing with termination of the Employee's employment as a result of Involuntary Termination at any time within a Change of Control Protection Period and ending with the date \_\_\_\_\_months following the date of the Employee's Involuntary Termination.

(e) "Code" shall mean the Internal Revenue Code of 1986, as amended.

(f) "Involuntary Termination" shall mean (i) the failure of a successor or an acquiring company to offer the Employee the position held by Employee on the date of this Agreement (or, if higher, a subsequent position of the Employee) with the successor or acquiring company following a Change of Control; (ii) without the Employee's express written consent, a substantial reduction, without good business reasons, of the rights, privileges and perquisites available to the Employee immediately prior to such reduction; (iii) without the Employee's express written consent, a material diminution in the authority, responsibilities, duties or reporting lines held or possessed by the Employee prior to the Change of Control; (iv) without the Employee's express written consent, a reduction by the Company of the Employee's base salary or target bonus as in effect immediately prior to such reduction; (v) without the Employee's express written consent, a material reduction by the Company in the kind or level of employee benefits to which the Employee is entitled immediately prior to such reduction with the result that the Employee's overall benefits package is significantly reduced; (vi) without the Employee's express written consent, the relocation of the regular offices of the Employee to a facility or a location more than thirty (30) miles further from the Employee's current location (unless such new facility or location is closer to the Employee's residence); (vii) any purported termination of the Employee by the Company which is not effected for Cause or for which the grounds relied upon are not valid; or (viii) the failure of the Company to obtain the assumption of this Agreement by any successors contemplated in Section 7 below.

2. Term of Agreement. This Agreement shall terminate upon the date that all obligations of the parties hereto under this Agreement have been satisfied or, if earlier, on the date, prior to a Change of Control Protection Period, the Employee is no longer employed by the Company.

3. At-Will Employment. The Company and the Employee acknowledge that the Employee's employment is and shall continue to be at-will, as defined under applicable law. If the Employee's employment terminates for any reason, the Employee shall not be entitled to any payments, benefits, damages, awards or compensation other than as provided by this Agreement or the Existing Agreement or as may otherwise be established under the Company's then existing employee benefit plans or policies at the time of termination.

4. Change of Control and Severance Benefits.

(a) Option Acceleration and Extended Exercise Period. If the Employee's employment with the Company terminates as a result of an Involuntary Termination at any time within a Change of Control Protection Period, then the exercisability of all options granted to the Employee by the Company (including any such options granted or assumed by the surviving or continuing entity of the Change of Control) and still outstanding (the "Options") shall automatically be accelerated so that all the Options may be exercised immediately upon such Involuntary Termination for any or all of the shares subject thereto and the post-termination exercise period of each Option shall be extended to sixty (60) months (but in no event beyond the remainder of the maximum term of the Option). The Options shall continue to be subject to all other terms and conditions of the Company's share option plans and the applicable option agreements between the Employee and the Company.

(b) Outplacement Program. If the Employee's employment with the Company terminates as a result of an Involuntary Termination at any time within a Change of Control Protection Period, the Employee will immediately become entitled to participate in a twelve (12) month executive outplacement program provided by an executive outplacement service, at the Company's expense not to exceed fifteen thousand dollars (\$15,000).

(c) Termination Following a Change of Control.

(i) Cash Severance Payment Upon Involuntary Termination. If the Employee's employment with the Company terminates as a result of an Involuntary Termination at any time within a Change of Control Protection Period, then the Employee shall be entitled to receive a severance payment equal to the sum of (A) an amount equal to \_\_\_\_\_ times the Employee's annual base salary as in effect immediately prior to the Involuntary Termination, plus (B) an amount equal to \_\_\_\_\_ times Employee's target bonus as in effect for the fiscal year in which the Involuntary Termination occurs. Such severance payments shall be in lieu of any other severance payment to which the Employee shall be entitled as a result of such termination pursuant to this Agreement, any employment agreement with or offer letter from the Company or any of its affiliates or the Company's or any of its affiliate's then existing severance plans and policies. The severance payment described in Section 4(c)(i)(A) shall be paid in monthly installments over [            ]

months (the "Severance Payment Period"), with the first two (2) of such monthly installments being paid sixty (60) days after the date of termination and the remaining monthly installments being paid monthly thereafter until fully paid, and the severance payments described in Section 4(c)(i)(B) shall be paid in a lump sum sixty (60) days after the date of termination; provided, however, that all of such severance payments shall be subject to the requirements of Section 4(c)(iii) and Section 9 below.

(ii) Provision of Group Health and Certain Other Benefits. In addition, during a period of \_\_\_\_\_ months following the termination of Employee's employment as a result of an Involuntary Termination at any time within a Change of Control Protection Period, (A) the Company shall make available and pay for the full cost of the coverage (plus an additional amount to pay for the taxes on such payments, if any, plus any taxes on such additional amount, such amount to be paid no later than ten (10) days prior to the date such taxes are due) of the Employee and Employee's spouse and eligible dependents under any group health plans of the Company on the date of such termination of employment at the same level of health (i.e., medical, vision and dental) coverage and benefits as in effect for the Employee or such covered dependents on the date immediately preceding the date of the Employee's termination; provided, however, that (1) the Employee and Employee's spouse and eligible dependents each constitutes a qualified beneficiary, as defined in Section 4980B(g)(1) of the Internal Revenue Code of 1986, as amended; and (2) the Employee elects continuation coverage pursuant to the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended ("COBRA"), within the time period prescribed pursuant to COBRA; and (B) if Employee is, at the time of such termination, an eligible participant in the Company's mortgage differential program, the Company shall continue to make mortgage assistance payments to Employee pursuant to such program as in effect at the time of such termination. Notwithstanding the foregoing, the payments by the Company for such group health coverage and/or mortgage assistance, as applicable, shall cease prior to the expiration of the \_\_\_\_\_ month period in this Section 4(c)(ii) upon the employment of the Employee by another employer. Furthermore, if, at the time of the termination of Employee's employment as a result of an Involuntary Termination at any time within a Change of Control Protection Period, Employee is the obligor of a "forgivable" loan (i.e., a loan which by its terms is to be considered forgiven by the Company and paid by the obligor in circumstances other than actual repayment) from the Company, then, notwithstanding any provisions of such loan to the contrary, such loan shall remain outstanding, and the forgiveness thereof shall continue, for a period of \_\_\_\_\_ months following such termination in accordance with the terms of such loan in effect at the time of such termination; provided, however, that at the end of such period of \_\_\_\_\_ months, the outstanding balance of such loan shall be immediately due and payable, together with any accrued and unpaid interest thereon.

(iii) Section 409A of the Code. Notwithstanding any provision to the contrary in this Agreement, if the Employee is deemed on the date of his or her "separation from service" (within the meaning of Treas. Reg. Section 1.409A-1(h)) with the Company to be a "specified employee" (within the meaning of Treas. Reg. Section 1.409A-1(i)), then with regard to any payment or benefit (including, without limitation, any mortgage assistance payment or loan forgiveness referred to above) that is considered deferred compensation under Section 409A payable on account of a "separation from service" that is required

to be delayed pursuant to Section 409A(a)(2)(B) of the Code (after taking into account any applicable exceptions to such requirement), such payment or benefit shall be made or provided on the date that is the earlier of (i) the expiration of the six (6)-month period measured from the date of the Employee's "separation from service," or (ii) the date of the Employee's death (the "Delay Period"). Upon the expiration of the Delay Period, all payments and benefits delayed pursuant to this Section 4(c) (whether they would have otherwise been payable in a single sum or in installments in the absence of such delay) shall be paid or reimbursed to the Employee in a lump sum and any remaining payments and benefits due under this Agreement shall be paid or provided in accordance with the normal payment dates specified for them herein. Notwithstanding any provision of this Agreement to the contrary, for purposes of any provision of this Agreement providing for the payment of any amounts or benefits upon or following a termination of employment, references to the Employee's "termination of employment" (and corollary terms) with the Company shall be construed to refer to Employee's "separation from service" (within the meaning of Treas. Reg. Section 1.409A-1(h)) with the Company.

(iv) Voluntary Resignation or Termination for Cause. If the Employee's employment with the Company terminates as a result of the Employee's voluntary resignation which is not an Involuntary Termination or if the Employee is terminated for Cause at any time after a Change of Control, then the Employee shall not be entitled to receive severance or other benefits hereunder, but may be eligible for those benefits (if any) as may then be established under the Company's then existing severance and benefits plans and policies at the time of such termination.

(d) Disability or Death. If the Employee's employment with the Company terminates due to the Employee's death or disability following a Change of Control, then the Employee shall not be entitled to receive severance or other benefits hereunder, except for those (if any) as may be then established under the Company's then existing severance and benefits plans and policies at the time of such disability or death. In the event of the Employee's death or disability after the termination of the Employee's employment with the Company as a result of an Involuntary Termination within a Change of Control Protection Period, the Employee's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees shall be entitled to receive severance or other benefits hereunder.

(e) Accrued Wages and Vacation; Expenses. Without regard to the reason for, or the timing of, the Employee's termination of employment (and without duplication of any similar benefits under any employment agreement with the Company or any of its affiliates): (i) the Company shall pay the Employee any unpaid base salary due for periods prior to the date of termination; (ii) the Company shall pay the Employee all of the Employee's accrued and unused vacation through the date of termination; and (iii) following submission of proper expense reports by the Employee, the Company shall reimburse the Employee for all expenses reasonably and necessarily incurred by the Employee in connection with the business of the Company prior to the date of termination. These payments shall be made promptly upon termination, within the period of time mandated by law, and in no event later than ten (10) days after the date of termination.

## 5. Conditional Nature of Severance Payments

(a) Non-Compete. The Employee shall not, to the detriment of the Company or any of its affiliates, disclose or reveal to any unauthorized person any trade secret or other confidential information relating to the Company or its affiliates or to any businesses operated by them, and the Employee confirms that such information constitutes the exclusive property of the Company. The Employee shall not otherwise act or conduct her/himself to the material detriment of the Company or its affiliates, or in a manner which is inimical or contrary to the interests thereof, and, for a period of twenty-four (24) months following the termination of Employee's employment as a result of an Involuntary Termination at any time within a Change of Control Protection Period, shall not, directly or indirectly, engage in or render any service (whether to a person, firm or business) in direct competition with the Company; provided, however, that the Employee's ownership of less than five percent (5%) of the outstanding stock of a corporation shall not itself be deemed to constitute such competition. The Employee recognizes that the possible restrictions on her/his activities which may occur as a result of her/his performance of her/his obligations under this Section 5(a) are required for the reasonable protection of the Company and its investments. For purposes hereof, "in direct competition" means engaged in the research, development and/or production of biological materials intended for use as therapeutic, prophylactic or diagnostic products in one or more of the same indications, and that utilize one or more of the same scientific bases (e.g., in the case of a therapeutic antibody, targets the same signal initiating pathway), as a product or product candidate the research, development and/or production of which is an active part of the Company's business plan at the time of Employee's termination.

(b) Non-Disparagement. The Employee and the Company agree to refrain from any defamation, libel or slander of the other and its respective officers, directors, employees, representatives, investors, shareholders, administrators, affiliates, divisions, subsidiaries, predecessor and successor corporations and assigns or tortious interference with the contracts and relationships of the other and its respective officers, directors, employees, representatives, investors, shareholders, administrators, affiliates, divisions, subsidiaries, predecessor and successor corporations and assigns.

(c) Understanding of Covenants. The Employee represents that the Employee (i) is familiar with the foregoing covenants not to compete and not to disparage, and (ii) is fully aware of the Employee's obligations hereunder, including, without limitation, the reasonableness of the length of time, scope and geographic coverage of the covenant not to compete.

6. Golden Parachute Excise Tax. In the event that the benefits provided for in this Agreement or otherwise payable to the Employee constitute "parachute payments" within the meaning of Section 280G of the Internal Revenue Code of 1986, as amended (the "Code") that are subject to the excise tax imposed by Section 4999 of the Code (the "Excise Tax"), then the Employee shall receive (i) a one-time payment from the Company sufficient to pay such excise tax (the "Excise Tax Gross-Up"), and (ii) an additional one-time payment from the Company sufficient to pay the additional excise tax and federal,

state and local income and employment taxes arising from the Excise Tax Gross-Up made by the Company to the Employee pursuant to this Section 6 (the "Additional Gross-Up"). Unless the Company and the Employee otherwise agree in writing, the determination of the Employee's excise tax liability and the amount required to be paid under this Section 6 shall be made in writing in good faith by the accounting firm serving as the Company's independent public accountants immediately prior to the Change of Control (the "Accountants"). The initial Excise Tax Gross-Up and Additional Gross-Up payments hereunder, if any, shall either be (x) paid to the Employee no later than ten (10) days prior to the due date for the payment of any excise tax, or (y) paid to the Internal Revenue Service on behalf of the Employee no later than the due date for the payment of any excise tax. In the event that the Excise Tax incurred by the Employee is determined by the Internal Revenue Service to be greater or lesser than the amount so determined by the Accountants, the Company and the Employee agree to promptly (but in no event later than the end of the calendar year in which the applicable taxes are paid to (or received from) the Internal Revenue Service) make such additional payment, including interest and any tax penalties, to the other party as the Accountants reasonably determine is appropriate. For purposes of making the calculations required by this Section 6, the Accountants may make reasonable assumptions and approximations concerning applicable taxes and may rely on interpretations concerning the application of the Code for which there is a "substantial authority" tax reporting position. The Company and the Employee shall furnish to the Accountants such information and documents as the Accountants may reasonably request in order to make a determination under this Section 6. The Company shall bear all costs the Accountants may reasonably incur in connection with any calculations contemplated by this Section 6.

7. Successors.

(a) Company's Successors. Any successor to the Company (whether direct or indirect and whether by purchase, lease, merger, amalgamation, consolidation, liquidation or otherwise) to all or substantially all of the Company's business and/or assets shall assume the Company's obligations under this Agreement and agree expressly to perform the Company's obligations under this Agreement in the same manner and to the same extent as the Company would be required to perform such obligations in the absence of a succession. For all purposes under this Agreement, the term "Company" shall include any successor to the Company's business and/or assets which executes and delivers the assumption agreement described in this subsection (a) or which becomes bound by the terms of this Agreement by operation of law.

(b) Employee's Successors. Without the written consent of the Company, the Employee shall not assign or transfer this Agreement or any right or obligation under this Agreement to any other person or entity. Notwithstanding the foregoing, the terms of this Agreement and all rights of the Employee hereunder shall inure to the benefit of, and be enforceable by, the Employee's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees.

8. Notices.

(a) General. Notices and all other communications contemplated by this Agreement shall be in writing and shall be deemed to have been duly given when personally delivered or when mailed by U.S. registered or certified mail, return receipt requested and postage prepaid. In the case of the Employee, mailed notices shall be addressed to the Employee at the home address that the Employee most recently communicated to the Company in writing. In the case of the Company, mailed notices shall be addressed to its corporate headquarters, and all notices shall be directed to the attention of its Secretary.

(b) Notice of Termination. Any termination by the Company for Cause or by the Employee as a result of a voluntary resignation or an Involuntary Termination shall be communicated by a notice of termination to the other party hereto given in accordance with this Section 8. Such notice shall indicate the specific termination provision in this Agreement relied upon, shall set forth in reasonable detail the facts and circumstances claimed to provide a basis for termination under the provision so indicated. The failure by the Employee to include in the notice any fact or circumstance which contributes to a showing of Involuntary Termination shall not waive any right of the Employee hereunder or preclude the Employee from asserting such fact or circumstance in enforcing the Employee's rights hereunder.

9. Execution of Release Agreement Upon Termination. As a condition of entering into this Agreement and receiving the benefits under Section 4, the Employee agrees to execute, on or before the date that is fifty (50) days following the date of termination, and not revoke a release of claims agreement substantially in the form attached hereto as Exhibit A upon the termination of the Employee's employment with the Company. Such release shall not, however, apply to the rights and claims of the Employee under this Agreement, any indemnification agreement between the Employee and the Company (or its successor or acquirer), the bye-laws of the Company (or its successor or acquirer), the share award agreements between the Employee and the Company (or its successor or acquirer), or any employee benefit plan of which the Employee is a participant and under which all benefits due under such plan have not yet been paid or provided.

10. Arbitration.

(a) Any dispute or controversy arising out of, relating to, or in connection with this Agreement, or the interpretation, validity, construction, performance, breach, or termination thereof, shall be settled by binding arbitration to be held in San Francisco or Alameda County, California, in accordance with the National Rules for the Resolution of Employment Disputes then in effect of the American Arbitration Association (the "Rules"). The cost of the arbitration shall be borne in full by the Company (or its successor or acquirer) but each of the Employee and the Company (or its successor or acquirer) shall bear his, her or its own legal fees and other cost in such arbitration subject to a possible award of attorneys fees and costs by the arbitrator as provided in the arbitration ruling. The arbitrator may grant injunctions or other relief in such dispute or controversy. The decision of the arbitrator shall be final, conclusive and binding on the parties to the arbitration. Judgment may be entered on the arbitrator's decision in any court having jurisdiction.

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(b) The arbitrator(s) shall apply California law to the merits of any dispute or claim, without reference to conflicts of law rules. The arbitration proceedings shall be governed by federal arbitration law and by the Rules, without reference to state arbitration law. The Employee hereby consents to the personal jurisdiction of the state and federal courts located in California for any action or proceeding arising from or relating to this Agreement or relating to any arbitration in which the parties are participants.

(c) The Employee understands that nothing in this Section 10 modifies the Employee's at-will employment status. Either the Employee or the Company can terminate the employment relationship at any time, with or without cause.

(d) THE EMPLOYEE HAS READ AND UNDERSTANDS THIS SECTION, WHICH DISCUSSES ARBITRATION. THE EMPLOYEE UNDERSTANDS THAT SUBMITTING ANY CLAIMS ARISING OUT OF, RELATING TO, OR IN CONNECTION WITH THIS AGREEMENT, OR THE INTERPRETATION, VALIDITY, CONSTRUCTION, PERFORMANCE, BREACH OR TERMINATION THEREOF TO BINDING ARBITRATION TO THE EXTENT PERMITTED BY LAW, AND THAT THIS ARBITRATION CLAUSE CONSTITUTES A WAIVER OF THE EMPLOYEE'S RIGHT TO A JURY TRIAL AND RELATES TO THE RESOLUTION OF ALL DISPUTES RELATING TO ALL ASPECTS OF THE EMPLOYER/EMPLOYEE RELATIONSHIP, INCLUDING BUT NOT LIMITED TO, THE FOLLOWING CLAIMS:

(i) ANY AND ALL CLAIMS FOR WRONGFUL DISCHARGE OF EMPLOYMENT; BREACH OF CONTRACT, BOTH EXPRESS AND IMPLIED; BREACH OF THE COVENANT OF GOOD FAITH AND FAIR DEALING, BOTH EXPRESS AND IMPLIED; NEGLIGENT OR INTENTIONAL INFLICTION OF EMOTIONAL DISTRESS; NEGLIGENT OR INTENTIONAL MISREPRESENTATION; NEGLIGENT OR INTENTIONAL INTERFERENCE WITH CONTRACT OR PROSPECTIVE ECONOMIC ADVANTAGE; AND DEFAMATION.

(ii) ANY AND ALL CLAIMS FOR VIOLATION OF ANY FEDERAL STATE OR MUNICIPAL STATUTE, INCLUDING, BUT NOT LIMITED TO, TITLE VII OF THE CIVIL RIGHTS ACT OF 1964, THE CIVIL RIGHTS ACT OF 1991, THE AGE DISCRIMINATION IN EMPLOYMENT ACT OF 1967, THE AMERICANS WITH DISABILITIES ACT OF 1990, THE FAIR LABOR STANDARDS ACT, THE CALIFORNIA FAIR EMPLOYMENT AND HOUSING ACT, AND LABOR CODE SECTION 201, *et seq*;

(iii) ANY AND ALL CLAIMS ARISING OUT OF ANY OTHER LAWS AND REGULATIONS RELATING TO EMPLOYMENT OR EMPLOYMENT DISCRIMINATION.

11. Miscellaneous Provisions.

(a) Mitigation. The Employee shall not be required to mitigate the amount of any payment contemplated by this Agreement, nor shall any such payment be reduced by any earnings that the Employee may receive from any other source. However, the Employee shall not be entitled to receive the health coverage and benefits contemplated by this Agreement in the event that the Employee receives similar health coverage and benefits as a result of new employment during the Compensation Continuation Period.

(b) Waiver. No provision of this Agreement may be modified, waived or discharged unless the modification, waiver or discharge is agreed to in writing and signed by the Employee and by an authorized officer of the Company (other than the Employee). No waiver by either party of any breach of, or of compliance with, any condition or provision of this Agreement by the other party shall be considered a waiver of any other condition or provision or of the same condition or provision at another time.

(c) Integration. This Agreement represents the entire agreement and understanding between the parties with respect to the subject matter herein but shall not supersede any employment agreement between the Company or any of its affiliates and the Employee, any indemnification agreement between the Employee and the Company (or its successor or acquirer), the share award agreements between the Employee and the Company (or its successor or acquirer), or any employee benefit plan of which the Employee is a participant and under which all benefits due under such plan have not yet been paid or provided.

(d) Choice of Law. The validity, interpretation, construction and performance of this Agreement shall be governed by the internal substantive laws, but not the conflicts of law rules, of the State of California.

(e) Severability. The invalidity or unenforceability of any provision or provisions of this Agreement shall not affect the validity or enforceability of any other provision hereof, which shall remain in full force and effect.

(f) Tax Withholdings. All payments made pursuant to this Agreement shall be subject to withholding of applicable income and employment taxes.

(g) Compliance with Section 409A of the Code.

(i) It is intended that this Agreement will comply with Section 409A of the Code and any regulations and guidelines promulgated thereunder (collectively, "Section 409A"), to the extent the Agreement is subject thereto, and the Agreement shall be interpreted on a basis consistent with such intent. If an amendment of the Agreement is necessary in order for it to comply with Section 409A of the Code, the parties hereto will negotiate in good faith to amend the Agreement in a manner that preserves the original intent of the parties to the extent reasonably possible. No action or failure to act pursuant to this Section 11(g) shall subject the Company to any claim, liability, or expense, and the Company shall not have any obligation to indemnify or otherwise protect the Employee from the obligation to pay any taxes, interest or penalties pursuant to Section 409A of the Code.

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(ii) With respect to any reimbursement or in-kind benefit arrangements of the Company and its subsidiaries that constitute deferred compensation for purposes of Section 409A, except as otherwise permitted by Section 409A, the following conditions shall be applicable: (A) the amount eligible for reimbursement, or in-kind benefits provided, under any such arrangement in one calendar year may not affect the amount eligible for reimbursement, or in-kind benefits to be provided, under such arrangement in any other calendar year (except that the health and dental plans may impose a limit on the amount that may be reimbursed or paid), (B) any reimbursement must be made on or before the last day of the calendar year following the calendar year in which the expense was incurred, and (C) the right to reimbursement or in-kind benefits is not subject to liquidation or exchange for another benefit. Whenever a payment under this Agreement specifies a payment period with reference to a number of days (e.g., "payment shall be made within thirty (30) days after termination of employment"), the actual date of payment within the specified period shall be within the sole discretion of the Company. Whenever payments under this Agreement are to be made in installments, each such installment shall be deemed to be a separate payment for purposes of Section 409A.

(h) Counterparts. This Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which together will constitute one and the same instrument.

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IN WITNESS WHEREOF, each of the parties has executed this Agreement, in the case of the Company by its duly authorized officer, as of the day and year first above written.

**COMPANY:**

**XOMA LTD.**

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

Name:

[Independent Director or CEO]

**EMPLOYEE:**

\_\_\_\_\_  
Name

**EXHIBIT A**

**FORM RELEASE OF CLAIMS AGREEMENT**

This Release of Claims Agreement (this "Agreement") is made and entered into by and between XOMA Ltd. (the "Company") and \_\_\_\_\_ (the "Employee").

WHEREAS, the Employee was employed by the Company; and

WHEREAS, the Company and the Employee have entered into a Change of Control Severance Agreement effective as of \_\_\_\_\_, 2007 (the "Severance Agreement").

NOW THEREFORE, in consideration of the mutual promises made herein and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Company and the Employee (collectively referred to as the "Parties") desiring to be legally bound do hereby agree as follows:

1. Termination. The Employee's employment with the Company terminated on \_\_\_\_\_, 20\_\_.

2. Consideration. Subject to and in consideration of the Employee's release of claims as provided herein, the Company has agreed to pay the Employee certain benefits and the Employee has agreed to provide certain benefits to the Company, both as set forth in the Severance Agreement.

3. Release of Claims. The Employee agrees that the foregoing consideration represents settlement in full of all currently outstanding obligations owed to the Employee by the Company. The Employee, on the Employee's own behalf and the Employee's respective heirs, family members, executors and assigns, hereby fully and forever releases the Company and its past, present and future officers, agents, directors, employees, investors, shareholders, administrators, affiliates, divisions, subsidiaries, parents, predecessor and successor corporations, and assigns, from, and agrees not to sue or otherwise institute or cause to be instituted any legal or administrative proceedings concerning any claim, duty, obligation or cause of action relating to any matters of any kind, whether presently known or unknown, suspected or unsuspected, that the Employee may possess arising from any omissions, acts or facts that have occurred up until and including the Effective Date (as defined below) of this Agreement including, without limitation:

(a) any and all claims relating to or arising from the Employee's employment relationship with the Company and the termination of that relationship;

(b) any and all claims relating to, or arising from, the Employee's right to purchase, or actual purchase of shares of the Company, including, without limitation, any claims for fraud, misrepresentation, breach of fiduciary duty, breach of duty under applicable state corporate law and securities fraud under any state or federal law;

(c) any and all claims for wrongful discharge of employment, termination in violation of public policy, discrimination, breach of contract (both express and implied), breach of a covenant of good faith and fair dealing (both express and implied), promissory estoppel, negligent or intentional infliction of emotional distress, negligent or intentional misrepresentation, negligent or intentional interference with contract or prospective economic advantage, unfair business practices, defamation, libel, slander, negligence, personal injury, assault, battery, invasion of privacy, false imprisonment and conversion;

(d) any and all claims for violation of any federal, state or municipal statute, including, but not limited to, Title VII of the Civil Rights Act of 1964, the Civil Rights Act of 1991, the Age Discrimination in Employment Act of 1967, the Americans with Disabilities Act of 1990, the Fair Labor Standards Act, the Employee Retirement Income Security Act of 1974, The Worker Adjustment and Retraining Notification Act, the California Fair Employment and Housing Act, and Labor Code Section 201, *et seq.* and Section 970, *et seq.* and all amendments to each such Act as well as the regulations issued thereunder;

(e) any and all claims for violation of the federal or any state constitution;

(f) any and all claims arising out of any other laws and regulations relating to employment or employment discrimination; and

(g) any and all claims for attorneys' fees and costs.

The Employee agrees that the release set forth in this Section 3 shall be and remain in effect in all respects as a complete general release as to the matters released. Notwithstanding the foregoing, this release does not extend to any obligations now or subsequently incurred under this Agreement, the Severance Agreement, the Indemnification Agreement between the Employee and the Company (or its successor or acquirer), the outstanding share award agreements between the Employee and the Company (or its successor or acquirer), or any employee benefit plan of which the Employee is a participant and under which all benefits due under such plan have not yet been paid or provided.

4. Acknowledgment of Waiver of Claims under ADEA. The Employee acknowledges that the Employee is waiving and releasing any rights the Employee may have under the Age Discrimination in Employment Act of 1967 ("ADEA") and that this waiver and release is knowing and voluntary. The Employee and the Company agree that this waiver and release does not apply to any rights or claims that may arise under the ADEA after the Effective Date of this Agreement. The Employee acknowledges that the consideration given for this waiver and release agreement is in addition to anything of value to which the Employee was already entitled. The Employee further acknowledges that the Employee has been advised by this writing that (a) the Employee should consult with an attorney prior to executing this Agreement; (b) the Employee has at least twenty-one (21) days within which to consider this Agreement; (c) the Employee has seven (7) days following the execution of this Agreement by the Parties to revoke the Agreement;

and (d) this Agreement shall not be effective until the revocation period has expired. Any revocation should be in writing and delivered to the Company by the close of business on the seventh (7<sup>th</sup>) day from the date that the Employee signs this Agreement.

5. Civil Code Section 1542. The Employee represents that the Employee is not aware of any claims against the Company other than the claims that are released by this Agreement. The Employee acknowledges that the Employee has been advised by legal counsel and is familiar with the provisions of California Civil Code Section 1542, which provides as follows:

**A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HER OR HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HER OR HIM MUST HAVE MATERIALLY AFFECTED HER OR HIS SETTLEMENT WITH THE DEBTOR.**

The Employee, being aware of said code section, agrees to expressly waive any rights the Employee may have thereunder, as well as under any other statute or common law principles of similar effect.

6. No Pending or Future Lawsuits. The Employee represents that the Employee has no lawsuits, claims or actions pending in the Employee's name, or on behalf of any other person or entity, against the Company or any other person or entity referred to herein. The Employee also represents that the Employee does not intend to bring any claims on the Employee's own behalf or on behalf of any other person or entity against the Company or any other person or entity referred to herein except, if necessary, with respect to the agreements listed in the last sentence of Section 3 of this Agreement.

7. Confidentiality. The Employee agrees to use the Employee's best efforts to maintain in confidence the existence of this Agreement, the contents and terms of this Agreement, and the consideration for this Agreement (hereinafter collectively referred to as "Release Information"). The Employee agrees to take every reasonable precaution to prevent disclosure of any Release Information to third parties and agrees that there will be no publicity, directly or indirectly, concerning any Release Information. The Employee agrees to take every precaution to disclose Release Information only to those attorneys, accountants, governmental entities and family members who have a reasonable need to know of such Release Information.

8. No Adverse Cooperation. The Employee agrees the Employee will not act in any manner that might damage the business of the Company. The Employee agrees that the Employee will not counsel or assist any attorneys or their clients in the presentation or prosecution of any disputes, differences, grievances, claims, charges or complaints by any third party against the Company and/or any officer, director, employee, agent, representative, shareholder or attorney of the Company, unless compelled under a subpoena or other court order to do so.

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9. Costs. The Parties shall each bear their own costs, expert fees, attorneys' fees and other fees incurred in connection with this Agreement.

10. Authority. The Company represents and warrants that the undersigned has the authority to act on behalf of the Company and to bind the Company and all who may claim through it to the terms and conditions of this Agreement. The Employee represents and warrants that the Employee has the capacity to act on the Employee's own behalf and on behalf of all who might claim through the Employee to bind them to the terms and conditions of this Agreement.

11. No Representations. The Employee represents that the Employee has had the opportunity to consult with an attorney, and has carefully read and understands the scope and effect of the provisions of this Agreement. Neither party has relied upon any representations or statements made by the other party hereto which are not specifically set forth in this Agreement.

12. Severability. In the event that any provision hereof becomes or is declared by a court of competent jurisdiction to be illegal, unenforceable or void, this Agreement shall continue in full force and effect without said provision.

13. Entire Agreement. This Agreement and the Severance Agreement and the agreements and plans referenced therein represent the entire agreement and understanding between the Company and the Employee concerning the Employee's separation from the Company, and supersede and replace any and all prior agreements and understandings concerning the Employee's relationship with the Company and the Employee's compensation by the Company. This Agreement may only be amended in writing signed by the Employee and an executive officer of the Company.

14. Governing Law. This Agreement shall be governed by the internal substantive laws, but not the choice of law rules, of the State of California.

15. Effective Date. This Agreement is effective eight (8) days after it has been signed by the Parties (the "Effective Date") unless it is revoked by the Employee within seven (7) days of the execution of this Agreement by the Employee.

16. Counterparts. This Agreement may be executed in counterparts, and each counterpart shall have the same force and effect as an original and shall constitute an effective, binding agreement on the part of each of the undersigned.

17. Voluntary Execution of Agreement. This Agreement is executed voluntarily and without any duress or undue influence on the part or behalf of the Parties hereto, with the full intent of releasing all claims. The Parties acknowledge that:

(a) they have read this Agreement;

(b) they have been represented in the preparation, negotiation and execution of this Agreement by legal counsel of their own choice or that they have voluntarily declined to seek such counsel;

(c) they understand the terms and consequences of this Agreement and of the releases it contains; and

(d) they are fully aware of the legal and binding effect of this Agreement.

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IN WITNESS WHEREOF, the Parties have executed this Agreement on the respective dates set forth below.

**XOMA LTD.**

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

Title: \_\_\_\_\_

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

**EMPLOYEE**

\_\_\_\_\_  
Name

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

Terms of Individual Change of Control Severance Agreements With Named Executive Officers  
(to be read in conjunction with Form of Change of Control Severance Agreement)

<u>Name</u>	<u>Paragraph 1(d)</u>	<u>Paragraph 4(c)(i)</u>	<u>Paragraph 4(c)(ii)</u>
Steven B. Engle	24 months	2.0 24 months	24 months
Patrick J. Scannon, MD, PhD	18 months	1.5 18 months	18 months
Fred Kurland	18 months	1.5 18 months	18 months
Christopher J. Margolin	18 months	1.5 18 months	18 months
Robert S. Tenerowicz	18 months	1.5 18 months	18 months

[\*] indicates that a confidential portion of the text of this agreement has been omitted.

### **DISCOVERY COLLABORATION AGREEMENT**

This Discovery Collaboration Agreement (this "Agreement") is effective as of October 29, 2009 (the "Effective Date") and is made by and between The Chemo-Sero-Therapeutic Research Institute, a Japanese foundation having offices at 1-6-1 Okubo, Kumamoto-shi, Kumamoto 860-8568, Japan ("Kaketsuken"), and XOMA Development Corporation, a Delaware corporation and a member of XOMA Group (as defined below) having offices at 2910 Seventh Street, Berkeley, California 94710, USA ("XOMA"). Kaketsuken and XOMA are sometimes referred to herein individually as a "Party" and together as the "Parties."

#### BACKGROUND

A. Kaketsuken is engaged in the research and development of product candidates, including without limitation vaccine, Antibodies and blood plasma products, for use in treating and/or preventing human diseases.

B. XOMA has developed certain materials, technologies and related information, hereinafter identified as [\*], the Discovery Know-How and the Systems, that are useful to the discovery, optimization and development of Antibodies and related proteins.

C. XOMA and Kaketsuken, as specified herein, wish to form a collaboration directed toward identifying new Antibodies for diseases of interest to Kaketsuken and in the course of which, *inter alia*, XOMA would [\*].

D. Kaketsuken, on its own behalf and on behalf of its Affiliates, agrees to accept the Transferred Materials under the terms and conditions of this Agreement.

NOW, THEREFORE, in consideration of the premises and of the mutual covenants and agreements contained herein, XOMA and Kaketsuken agree as follows:

#### Section 1. DEFINITIONS

1.1 "Affiliate" means any corporation, company, partnership, joint venture and/or firm that controls, is controlled by or is under common control with a Party to this Agreement. For purposes hereof, "control" means (a) in the case of a corporate entity, direct or indirect ownership of more than fifty percent (50%) of the stock or shares entitled to vote for the election of directors; (b) in the case of a non-corporate entity, direct or indirect ownership of more than fifty percent (50%) of the equity interests with the power to direct the management and policies of such non-corporate entity; or (c) possession, directly or indirectly, of the power to direct or cause the direction of the management or policies of the entity in question (whether through ownership of securities or other ownership interests, by contract or otherwise).

1.2 “Antibody” shall mean any molecule, including full immunoglobulin molecules (e.g., IgG, IgM, IgE, IgA and IgD molecules) and ScFv, Fv and Fab molecules, that has an amino acid sequence by virtue of which it specifically interacts with an antigen, immunogen or hapten or which elicits an immune response and wherein that amino acid sequence consists essentially of a functionally operating region of an antibody variable region, including any naturally occurring or recombinant form of such a molecule.

1.3 “Antibody Product” means any composition of matter or article of manufacture consisting essentially of an Antibody (a) alone or (b) integrally associated with a composition of matter or article of manufacture (including without limitation conjugates bound to a toxin, label or other moiety) providing therapeutic, half-life, safety or other advantages to the Antibody.

1.4 “Applicable Interest Rate” has the meaning specified in Section 13(d) hereof.

1.5 “Bacterial Cell Expression Patent Rights” or “BCE Patent Rights” means the Patent Rights described on Schedule 1.5.

1.6 “Bankruptcy Code” has the meaning specified in Section 19(c) hereof.

1.7 “BLA” means a Biologics Licensing Application or New Drug Application (each as defined in the FDC Act) and any other equivalent marketing authorization application or other license, registration or application seeking approval from a Regulatory Authority to market a Licensed Product in the Field in the Territory.

1.8 “Change of Control” means any transaction or series of transactions with respect to an entity as a result of which any person or group (as defined under the U.S. Securities Exchange Act of 1934, as amended) becomes, directly or indirectly, the beneficial owner of more than fifty percent (50%) of the total voting power of such entity’s equity securities or otherwise gains control of such entity.

1.9 “Collaboration” has the meaning specified in Section 2(a) hereof.

1.10 “Collaboration Committee” has the meaning specified in Section 2(c) hereof.

1.11 “Combination Product” has the meaning specified in Section 1.38 hereof.

1.12 “Commercialization” or “Commercialize” means activities directed to obtaining pricing and reimbursement approvals, marketing, promoting, manufacturing for sale, offering for sale, distributing, importing, exporting or selling a product.

1.13 “Commercially Reasonable and Diligent Efforts” means the carrying out of obligations or tasks by a Party in a sustained manner using good faith commercially reasonable and diligent efforts, which efforts shall be consistent with the exercise of prudent scientific and business judgment, taking into account the competitiveness of the market place, the regulatory structure involved and other relevant and material factors, in accordance with either (a) the efforts such Party devotes to products or research and development projects of similar scientific and

commercial potential, or (b) if such Party does not have and has not had any such products or projects, the efforts a peer company in the biopharmaceutical industry would devote, in accordance with industry standards and practices, to products or research and development projects of similar scientific and commercial potential, and subject in any event to all applicable limitations, restrictions and obligations provided for in this Agreement and the terms of any license or grant of rights from or other agreement between such Party and any Third Party the benefit of which is claimed by the other Party.

1.14 “Confidential Information” means any information and data received by a Party (the “Receiving Party”) from the other Party or its Affiliates (the “Disclosing Party”) in connection with this Agreement or the Mutual Confidentiality Agreement effective as of August 27, 2008 between Kaketsuken and XOMA (US) LLC. Notwithstanding the foregoing, Confidential Information shall not include any part of such information or data:

(a) which is or becomes public knowledge (through no fault of the Receiving Party); or

(b) which is made available to the Receiving Party by a Third Party not under an obligation of confidentiality with the Disclosing Party (and such lawful right can be demonstrated by the Receiving Party’s written records); or

(c) which is already rightfully in the Receiving Party’s possession at the time of receipt from the Disclosing Party (and such prior possession can be demonstrated by the Receiving Party’s written records); or

(d) which is independently developed by an employee of the Receiving Party and/or its Affiliates without the aid, application or use of confidential information disclosed by the Disclosing Party (and such independent development can be demonstrated by the Receiving Party’s written records).

1.15 “Contact Person” has the meaning specified in Section 3(e) hereof.

1.16 “Control” or “Controlled” means, with respect to any (a) material, document, item of information, method, data or other Know-How or (b) Patent Right or other intellectual property right, the possession (whether by ownership or license, other than by a license granted pursuant to this Agreement) by a Party or its Affiliates of the ability or right to grant to the other Party access, ownership, a license and/or a sublicense as provided herein under such item or right without violating the terms of any agreement or other arrangement with any Third Party as of the Effective Date or, if such right is acquired after the Effective Date, as of the date a Party first gained possession of such right.

1.17 “Disclosing Party” has the meaning specified in Section 1.14 hereof.

1.18 “Discovery Know-How” means the Know-How transferred to Kaketsuken or its Affiliates pursuant to Section 3 as well as any Know-How arising out of the use of [\*] or the Discovery Know-How.

1.19 “Discovery Patent Rights” means the Patent Rights described on Schedule 1.19, which XOMA shall update from time to time to include any Patents Rights covering [\*] or the use thereof Controlled by XOMA or its Affiliates after the Effective Date.

1.20 “Discovery Product” means an Antibody or Antibody Product derived from or arising out of, directly or indirectly, the use of [\*] the Discovery Know-How and/or the practice of the Discovery Patent Rights, including without limitation through the use of [\*] the Discovery Know-How and/or the practice of the Discovery Patent Rights to identify, validate or otherwise use a Target and/or its associated ligand or receptor. As used herein, to “validate” a Target includes any activities by which, using [\*], Discovery Know-How, Discovery Patent Rights and/or any Antibody arising therefrom, a Target is identified, determined, confirmed and/or validated as being significant in a disease or other biological pathway or used in any manner to develop a therapeutic and/or prophylactic compound or product.

1.21 “EMA” means the European Medicines Agency or any successor thereto.

1.22 “Event of Default” means an event described in Section 18(b)(i) hereof.

1.23 “FDA” means the United States Food and Drug Administration, or any successor thereto.

1.24 “FDC Act” means the United States Food, Drug and Cosmetic Act (or any successor thereto), as amended, and the rules and regulations promulgated thereunder.

1.25 “Field” means the discovery, research, development, manufacture and/or commercialization of Licensed Products for the treatment, palliation or prevention of any disease or condition in humans.

1.26 “First Commercial Sale” means the first sale for use or consumption by the general public of a Licensed Product in a country after Regulatory Approval has been obtained in such country. For the avoidance of doubt, First Commercial Sale shall not include the sale of any Licensed Product for use in clinical trials or for compassionate use prior to Regulatory Approval.

1.27 “GAAP” means United States generally accepted accounting principles, as they exist from time to time, consistently applied.

1.28 “ICC” has the meaning specified in Section 19(h)(ii) hereof.

1.29 “Indemnitee” has the meaning specified in Section 17(d) hereof.

1.30 “Indemnitor” has the meaning specified in Section 17(d) hereof.

1.31 “Inventions” has the meaning specified in Section 6 hereof.

1.32 “Kaketsuken Licensee” means, solely with respect to Licensed Products discovered or modified by Kaketsuken through the use of any of the Transferred Materials or the practice of any of the Licensed Patent Rights, any Third Party to whom Kaketsuken licenses or grants

rights, as part of a bona fide collaboration, development, commercialization or marketing arrangement, to develop, commercialize, market or distribute any such Licensed Product. No Third Party shall be a Kaketsuken Licensee if (a) such Third Party is at the time of determination either misappropriating the Licensed Know-How or infringing any of the Licensed Patent Rights or (b) such Kaketsuken Licensee does not take material economic risk with respect to the development or commercialization of the Licensed Product that is the subject of the applicable arrangement; *provided, however*, that the foregoing clause (b) shall not prevent Kaketsuken from using any Third Party as a distributor or selling agent. All arrangements with a Kaketsuken Licensee shall be pursuant to a written agreement, which will incorporate the applicable provisions of this Agreement and provide that XOMA and its Affiliates shall be third party beneficiaries thereof.

1.33 “Know-How” means any and all know-how, trade secrets, data, processes, techniques, procedures, compositions, materials, devices, methods, formulas, protocols, and research, preclinical and clinical data and information, including any and all chemical, biochemical, toxicological, and scientific research information, whether in written, electronic, graphic or video form or any other form or format. Know-How shall not include Patent Rights.

1.34 “Laws” means all laws, statutes, rules, regulations, ordinances and other pronouncements having the effect of law of any federal, national, multinational, state, provincial, county, city or other political subdivision, domestic or foreign.

1.35 “Licensed Know-How” means, collectively, the Discovery Know-How, the Systems Know-How and the TAE Know-How.

1.36 “Licensed Patent Rights” means, collectively, the Discovery Patent Rights, the Systems Patent Rights and the TAE Patent Rights.

1.37 “Licensed Product” means an Antibody or Antibody Product that is either a Discovery Product or a TAE-Only Product.

1.38 “Net Sales” means, with respect to a Licensed Product, the gross amount invoiced for sales of such Licensed Product to Third Parties (or Affiliates which are end users of such Licensed Product), less the following unreimbursed or non-refunded deductions with respect thereto, determined in accordance with GAAP and calculated in United States dollars and to the extent such amounts have not already been deducted from the amount invoiced: (a) amounts actually allowed as volume or quantity discounts, rebates, price reductions, returns (including recalls) and charge-backs, (b) sales, excise and turnover taxes and similar duties, levies and charges collected, charged or otherwise imposed directly upon and actually paid by such party and its Affiliates, and (c) all other direct expenses or discounts, including but not limited to cash discounts, custom duties and transportation and insurance charges.

In the event the Licensed Product is sold as part of a Combination Product (as defined below), the Net Sales from the Combination Product, for the purposes of determining royalty payments, will be determined by [\*].

In the event that the average sale price of the Licensed Product can be determined but the average sale price of the other active compounds or active ingredients in the Combination Product cannot be determined, Net Sales for purposes of determining royalty payments will be calculated by [\*]. If the average sale price of the other active compounds or active ingredients can be determined but the average price of the Licensed Product cannot be determined, Net Sales for purposes of determining royalty payments will be calculated by [\*].

In the event that the average sales price of both the Licensed Product and the other active compounds or active ingredients in the Combination Product cannot be determined, the Net Sales of the Licensed Product shall be negotiated in good faith by the Parties.

As used above, the term "Combination Product" means any Licensed Product sold in conjunction with any other active component(s) (whether packaged together or in the same therapeutic formulation).

Free samples of Licensed Product and the disposition of Licensed Product for, or the use of Licensed Product in, preclinical or clinical (Phase 1–3) trials or other market-focused (Phase 4) trials in which Licensed Product is provided to patients without any payment shall not result in any Net Sales.

1.39 "Patent Rights" means all patents and patent applications existing as of the Effective Date and all patent applications thereafter filed and patents thereafter issued, including, without limitation, any continuations, continuations-in-part, divisionals, provisionals or any substitute applications, any patent issued with respect to any such patent applications, any reissue, reexamination, renewal or extension (including any supplemental protection certificate) of any such patent, and any confirmation patent or registration patent or patent of addition based on any such patent, and all foreign counterparts of any of the foregoing.

1.40 "Phase 1 Trial" means a human clinical trial in any country that is intended to initially evaluate the safety and/or pharmacological effect of a Licensed Product in subjects or that would otherwise satisfy the requirements of 21 C.F.R. 312.21(a), or its foreign equivalent.

1.41 "Phase 2 Trial" means a human clinical trial in any country that is intended to initially evaluate the effectiveness of a Licensed Product for a particular indication or indications in patients with the disease or indication under study or that would otherwise satisfy the requirements of 21 C.F.R. 312.21(b), or its foreign equivalent

1.42 "Phase 3 Trial" means a pivotal human clinical trial in any country, the results of which could be used to establish safety and efficacy of a Licensed Product as a basis for a BLA or that would otherwise satisfy the requirements of 21 C.F.R. 312.21(c) or its foreign equivalent. In the event of a Phase 2/3 trial, initiation of Phase 3 shall be deemed to have occurred upon a decision by Kaketsuken to continue enrollment for the pivotal portion of such trial.

1.43 "Receiving Party" has the meaning specified in Section 1.14 hereof.

1.44 “Regulatory Approval” means any and all approvals (including any applicable governmental price and reimbursement approvals), licenses, registrations, or authorizations of any federal, national, multinational, state, provincial or local regulatory agency, department bureau or other governmental entity that are necessary for the manufacture, use, storage, import, transport, promotion, marketing and sale of a Licensed Product in the Field in a country or group of countries.

1.45 “Regulatory Authority” means any governmental authority in a country or region that regulates the manufacture or sale of pharmaceutical products, including the FDA and the EMEA, and any successors thereto.

1.46 “Representatives” has the meaning specified in Section 2(c) hereof.

1.47 “Research and Development” means, solely with respect to the use of the Transferred Materials by Kaketsuken, the conduct of activities relating to the discovery of Antibodies for Targets, the identification, characterization, selection, optimization and research of Antibodies and Licensed Products and the conduct of all tests, clinical and other studies and other activities (including test method development, toxicology studies, statistical analysis and report writing, preclinical and other testing, packaging and regulatory affairs, product approval and registration activities) related thereto as are customarily performed in the biopharmaceutical industry as part of research and development. Research and Development may include without limitation (a) the discovery of Antibodies that selectively bind to and act through Targets, (b) the development of assays for Antibodies to, *inter alia*, confirm the activity of such Antibodies or Target, and (c) the performance of affinity maturation on such Antibodies, in each case with the objective of identifying Antibodies that have potential as Licensed Products.

1.48 “Royalty Term” has the meaning specified in Section 11(a) hereof.

1.49 “Services” has the meaning specified in Section 4(a) hereof.

1.50 “Specification Confirmation” means (a) Kaketsuken has agreed that [\*] (or a repaired or replacement collection of polynucleotides as described in Section 3(a)(ii)) is in accordance with the [\*] Specifications as provided in Section 3(a) and XOMA has received Kaketsuken’s written notice to that effect in accordance with Section 3(a), (b) Kaketsuken is deemed to have agreed that [\*] (or such a repaired or replacement collection of polynucleotides) is in accordance with the [\*] Specifications as provided in Section 3(a), or (c) the Third Party reviewer provided for in Section 19(h)(i) has determined that [\*] (or such a repaired or replacement collection of polynucleotides) is in accordance with the [\*] Specifications as provided in Section 19(h)(i) and has notified the Parties of its determination.

1.51 “Systems” means the informatics and other materials handling systems, associated software applications and related data systems, Patent Rights related to the foregoing (the “Systems Patent Rights”) and related Know-How (the “Systems Know-How”), each as more particularly described on Schedule 1.51. For the purposes of this Agreement, Systems shall not include any Third Party software, operating system, data device or other materials not actually integrated into the software applications and related data systems constituting the Systems.

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- 1.52 “Systems Know-How” has the meaning specified in Section 1.51 hereof.
- 1.53 “Systems Patent Rights” has the meaning specified in Section 1.51 hereof.
- 1.54 “TAE Know-How” has the meaning specified in Section 1.58 hereof.
- 1.55 “TAE-Only Product” means an Antibody or Antibody Product that is not a Discovery Product and that Kaketsuken elects to develop using the TAE Know-How and/or practicing the TAE Patent Rights.
- 1.56 “TAE Patent Rights” has the meaning specified in Section 1.58 hereof.
- 1.57 “Target” means a gene and the products encoded by such gene, including, without limitation, (a) any partial or full-length DNA sequence from such gene (including any mutant or polymorphic forms thereof), (b) any RNA sequence (including any post-transcriptionally modified variants thereof) encoded by any such gene, (c) any peptide, polypeptide or protein (including any post-translationally modified variants thereof) encoded by any such gene, (d) any derivatives or fragments of any of the foregoing, and/or (e) any species variants or homologs of any of the foregoing.
- 1.58 “Target Affinity Enhancement Technology” or “TAE Technology” means (a) the materials and Know-How (the “TAE Know-How”) and (b) the Patent Rights (the “TAE Patent Rights”), each as more particularly described on Schedule 1.58, that set forth an embodiment of the technology made available by XOMA for improving or enhancing the affinity of an Antibody.
- 1.59 “Territory” means all of the countries and territories of the world.
- 1.60 “Third Party” means any person or entity other than Kaketsuken, XOMA and their respective Affiliates.
- 1.61 [\*]
- 1.62 [\*]
- 1.63 “Transferred Materials” means, collectively, [\*], the Licensed Know-How, the Systems and/or any related materials actually transferred to Kaketsuken pursuant to this Agreement.
- 1.64 “Valid Claim” means either (a) a claim of an issued and unexpired patent which has not been held permanently revoked, unenforceable or invalid by a decision of a court or other governmental agency of competent jurisdiction, unappealable or unappealed within the time allowed for appeal and that is not admitted to be invalid or unenforceable through reissue, disclaimer or otherwise, or (b) a claim of a pending parent patent application that has not been abandoned or finally rejected without the possibility of appeal or refiling.
- 1.65 “Validation Data” has the meaning specified in Section 3(a)(i) hereof.

1.66 “Verification Notice” has the meaning specified in Section 3(c)(i) hereof.

1.67 “Verification Tests” means the tests described on Schedule 1.67.

1.68 [\*]

1.69 “[\*]Specifications” means Kaketsuken’s specifications for [\*] set forth on Schedule 1.68.

1.70 “XOMA Group” means XOMA Ltd., a NASDAQ-listed Bermuda company, and its wholly-owned subsidiaries XOMA (Bermuda) Ltd., XOMA Ireland Limited, XOMA Limited, XOMA Technology Ltd., XOMA (US) LLC and XOMA.

## Section 2. COLLABORATION OVERVIEW

(a) Objectives. Kaketsuken and XOMA intend to collaborate in the discovery of Antibodies and/or Antibody Products, with (in general) XOMA constructing and/or transferring certain materials and providing access to certain intellectual property rights and Kaketsuken conducting various discovery and other activities, in each case as provided in or permitted by this Agreement (the “Collaboration”). It is intended that the Collaboration will be conducted as a collaborative effort with activities by the Parties carried out primarily at each Party’s respective facilities, except as otherwise provided herein.

(b) Cooperation. As part of the Collaboration, it is anticipated that each Party will provide the other Party with advice and the benefits of its experience within its areas of relative expertise that are relevant to the Collaboration (to the extent it may do so without violating any existing contractual or other obligations or surrendering any valuable trade secrets or other intellectual property rights not licensed hereunder). By way of example, (i) in the event Kaketsuken is unable to achieve a particular desired result with respect to one or more Targets using the Transferred Materials, then XOMA will provide advice, based on its then current knowledge, regarding one or more means of achieving such result, what additional intellectual property rights may be necessary in order for Kaketsuken to implement such means and from whom such rights might be acquired and (ii) in the event XOMA becomes aware of new Third Party intellectual property rights that are necessary in order to effectively use the Transferred Materials, then XOMA will notify Kaketsuken of such new intellectual property rights and from whom such rights might be acquired and, XOMA will in good faith undertake negotiations with such Third Party regarding such intellectual property rights, and make a good faith effort to include in such negotiations a right to sublicense such intellectual property rights to Kaketsuken, it being understood in any event that no such advice or other assistance shall be deemed an assurance that a solution to any problem will be found, that rights to such additional intellectual property can be acquired or that such advice represents a complete solution to such problem, and no provision of this Agreement shall obligate the Party providing any such advice or other assistance to solve any such problem, implement any proposed solution or expend any significant resources.

(c) Committee. As soon as practicable after the Effective Date, the Parties shall establish a committee (the “Collaboration Committee”) comprised of representatives designated by

each of XOMA and Kaketsuken, each of whom shall have experience and seniority sufficient to enable him or her to make decisions on behalf of the Party he or she represents within the scope of the authority of the Collaboration Committee as provided herein. The Collaboration Committee shall be responsible for overseeing and directing the Parties' interaction and performance of their respective obligations under this Agreement. In reaching decisions or taking action, the Collaboration Committee shall strive for unanimity. In the event unanimity cannot be reached, the matter shall be referred to the chief executive officers of XOMA and Kaketsuken, or their respective designees (the "Representatives"), for further review and resolution pursuant to Section 19(h)(ii).

### Section 3. DELIVERABLES; DELIVERY

#### (a) Specification Confirmation.

(i) On or after the Effective Date but prior to [\*], XOMA shall provide to Kaketsuken such data as is reasonably necessary to determine whether [\*] is in accordance with the [\*] Specifications (the "Validation Data"). Kaketsuken shall have [\*] following receipt of the Validation Data by Kaketsuken to determine whether it agrees that [\*] is in accordance with the [\*] Specifications and to notify XOMA in writing of its determination, or it shall be deemed to have agreed that [\*] is in accordance with the [\*] Specifications.

(ii) If, prior to the end of the [\*] period referred to in Section 3(a)(i), Kaketsuken notifies XOMA in writing that it has determined that [\*] is not in accordance with the [\*] Specifications, then, [\*] either (x) XOMA shall have a period of [\*] thereafter to carry out work on [\*] in order to bring it into accordance with the [\*] Specifications or to provide Kaketsuken with a comparable replacement collection of polynucleotides that meets the [\*] Specifications, or (y) the provisions of Section 19(h)(i) shall apply. If [\*] set forth in clause (x) of the immediately preceding sentence, then prior to the end of such [\*] period and prior to delivery of the repaired or replacement collection of polynucleotides to Kaketsuken, XOMA shall provide to Kaketsuken such data as is reasonably necessary to determine whether such repaired or replacement collection of polynucleotides is in accordance with the [\*] Specifications. Kaketsuken shall have [\*] following receipt of such data by Kaketsuken to determine whether it agrees that such repaired or replacement collection of polynucleotides is in accordance with the [\*] Specifications and to notify XOMA in writing of its determination, or it shall be deemed to have agreed that such repaired or replacement collection of polynucleotides is in accordance with the [\*] Specifications. If, prior to the end of such [\*] period, Kaketsuken notifies XOMA in writing that it has determined that such repaired or replacement collection of polynucleotides is not in accordance with the [\*] Specifications, then the provisions of Section 19(h)(i) shall apply. In the event of Specification Confirmation with respect to any such repaired or replacement collection of polynucleotides, such repaired or replacement collection of polynucleotides shall be deemed "[\*]" and part of the "Transferred Materials" for all purposes of this Agreement.

(b) Deliverables. Within [\*] following Specification Confirmation, XOMA shall deliver [\*], the Discovery Know-How relating thereto, the TAE Know-How and the Systems to Kaketsuken's facility (Kikuchi Research Center) located at Kyokushi kawabe, Kikuchi-shi, Kumamoto, Japan, as evidenced by the Delivery and Receipt Acknowledgement in the form attached as Exhibit A. At such time, XOMA shall provide [\*] in the quantities, and together with the additional information, set forth in Schedule 3(b); [\*].

(c) Verification.

(i) Once Kaketsuken receives [\*], Kaketsuken will promptly perform the Verification Tests. The Verification Tests set forth in Part A of Schedule 1.67 shall be performed by Kaketsuken with the guidance of XOMA representatives, who shall be [\*], it being understood that no portion of the Verification Tests, or any activities related thereto, will be conducted without the concurrence of XOMA's representatives. Kaketsuken shall have [\*] following receipt of [\*] by Kaketsuken to perform the Verification Tests and to notify XOMA in writing of the results thereof, or [\*] shall be deemed to have passed the Verification Tests. When [\*] has or is deemed to have passed the Verification Tests, Kaketsuken shall so inform XOMA in writing (the "Verification Notice").

(ii) If, prior to the end of the [\*] period referred to in Section 3(c)(i), Kaketsuken notifies XOMA in writing that the Verification Tests have been completed and [\*] has not passed the Verification Tests, then either (x) [\*], such [\*] period shall be extended for a period not to exceed [\*] in order to permit XOMA representatives to provide additional guidance to Kaketsuken in carrying out additional Verification Tests; *provided*, that in order for [\*] set forth in this clause (x), it must first [\*], or (y) if [\*] extend such [\*] period as provided in the preceding clause (x), Kaketsuken shall return the following to XOMA or, at XOMA's option, destroy the following and provide XOMA with a certificate confirming such destruction: (1) [\*], (2) all of the other Transferred Materials, or such portion(s) thereof as XOMA shall designate, and (3) any materials and/or data derived from or arising out of Kaketsuken's use of the Transferred Materials, or such portion(s) thereof as XOMA shall designate. Subject to Sections 18(e) and 19(h), in the event [\*] set forth in clause (x) of this Section 3(c)(ii) within [\*] following the end of the [\*] period referred to in Section 3(c)(i), then this Agreement shall be deemed terminated in its entirety. For the avoidance of doubt, Kaketsuken shall have no payment obligation under Section 9 in the event [\*] set forth in such clause (y).

(iii) Kaketsuken (A) shall bear all costs and expenses incurred by it in connection with the activities conducted pursuant to this Section 3(c), (B) will compensate XOMA for its activities conducted pursuant to this Section 3(c) at the rate of [\*] per person per hour [\*] for all XOMA Group personnel involved and (C) will reimburse XOMA for all reasonable travel, lodging and other expenses of XOMA's employees and consultants carrying out such activities documented to the reasonable satisfaction of Kaketsuken.

(d) Delivery. Delivery of the Transferred Materials shall be deemed to have taken place, F.O.B. XOMA's Berkeley, California, USA facility, upon provision of the same to an independent

carrier designated by XOMA and reasonably acceptable to Kaketsuken. Title and risk of loss shall transfer to Kaketsuken upon such delivery. All Transferred Materials will be delivered "as is." XOMA EXPRESSLY DISCLAIMS ANY AND ALL WARRANTIES, EXPRESS, IMPLIED OR STATUTORY, WITH RESPECT THERETO, INCLUDING WITHOUT LIMITATION MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE OR NON-INFRINGEMENT.

(e) Contact Person. XOMA shall provide written notice to Kaketsuken which shall identify the name and e-mail address of the person at XOMA ("Contact Person") to which Kaketsuken may provide any response or notice pursuant to this Section 3. [\*].

#### Section 4. SERVICES

(a) Services Defined. Upon the request of Kaketsuken, XOMA agrees to perform the services described in Schedule 4(a) (the "Services"). XOMA warrants that it has and/or will retain employees and/or consultants with the skills, ability and training necessary to, and that it shall, render the Services in a timely and professional manner consistent with industry standards in accordance with the terms of this Section 4, including Schedule 4(a). Subject to the foregoing, the manner and means by which XOMA chooses to complete the Services are in XOMA's sole discretion and control. XOMA's only service obligations with respect to the validation, implementation or use of the Transferred Materials at Kaketsuken shall be those expressly provided in Section 3(c) and this Section 4. For the avoidance of doubt, (i) the Services shall be in addition to the activities to be performed by XOMA under Section 3(c), and (ii) any employees and/or consultants of XOMA performing such activities or rendering the Services shall be bound by the same obligations as provided for in Section 15, and XOMA shall remain fully responsible to Kaketsuken for the fulfillment by them of the confidentiality obligations as provided therein.

(b) Expenses. Kaketsuken will reimburse XOMA for all reasonable travel, lodging and other expenses of XOMA's employees and consultants rendering the Services documented to the reasonable satisfaction of Kaketsuken.

(c) Other Services. XOMA (including its employees rendering the Services) may conduct activities with and provide services to, and its consultants rendering the Services may perform services for or be employed by, Third Parties so long as doing so does not cause XOMA to breach its obligations under this Section 4 or any other provision of this Agreement.

(d) Term. The Parties shall have no further rights or obligations with respect to this Section 4 (other than those accrued prior to such termination) upon the earliest of (i) termination of this Agreement in accordance with its terms, (ii) termination of this Section 4 by either Party upon a breach by the other Party of this Section 4 that is not cured within sixty (60) days of such other Party becoming aware of such breach, effective immediately upon written notice to the breaching Party, (iii) termination by Kaketsuken of this Section 4, at its discretion, upon prior written notice to XOMA [\*].

#### Section 5. GRANTS OF RIGHTS; [\*]

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(a) [\*], TAE Technology, Etc XOMA grants to Kaketsuken, on its own behalf and on behalf of its Affiliates, in the Field throughout the Territory, subject to the terms, conditions and limitations set forth in this Agreement:

(i) an exclusive (except as to the use of [\*] by XOMA and its Affiliates, as provided in Section 5(h)), non-transferable license and/or right, without the right to grant sublicenses, to use [\*] as delivered pursuant to Section 3(b) to Kaketsuken to identify, isolate, modify and develop Discovery Products; and

(ii) a non-exclusive, non-transferable license and/or right, without the right to grant sublicenses, to:

(x) use the Systems and/or the Discovery Know-How, and/or practice the Systems Patent Rights and/or the Discovery Patent Rights, in each case at Kaketsuken to discover, identify, isolate, modify and/or develop Discovery Products; and

(y) use the TAE Technology and/or the Systems, and/or practice the TAE Patent Rights and/or the Systems Patent Rights, in each case at Kaketsuken to alter, modify and/or express Antibodies and Antibody Products in order to discover, identify, isolate, modify and/or develop Licensed Products.

The grants provided for in this Section 5(a) include, to the extent required, a right and license to Kaketsuken, its Affiliates and any Kaketsuken Licensee, subject to the other limitations of this Agreement, to Commercialize any Licensed Product derived from or arising out of, directly or indirectly, the use of the Transferred Materials or the practice of the Licensed Patent Rights. The grant provided for under Section 5(a)(i) includes any Patent Right (other than the BCE Patent Rights, Kaketsuken's rights to which are addressed in clause (b) below), copyright or similar intellectual property right that is, as of the Effective Date, under the Control of XOMA and/or its Affiliates [\*] and shall be subject to all applicable limitations, restrictions and obligations provided for in this Agreement and the terms of any license or grant of rights from or other agreement with a Third Party [\*] the benefit of which is claimed by Kaketsuken.

(b) BCE Patent Rights. In addition, to the extent that the conduct by Kaketsuken of any of the activities expressly licensed by XOMA hereunder constitutes the practice of the BCE Patent Rights, Kaketsuken shall be deemed to have a non-exclusive license, without the right to grant sublicenses, under the BCE Patent Rights to conduct such activities solely as provided in, and as limited by, the scope of the license grants in Section 5(a). For the avoidance of doubt, the license granted pursuant to this Section 5(b) shall not include any right (i) to make or have made any quantities of any product, including an Antibody, in a prokaryote other than as reasonably necessary to conduct Research and Development activities, (ii) to conduct phage display other than with the Transferred Materials and/or (iii) to conduct any activities for a Third Party except as reasonably necessary for a Kaketsuken Licensee to make (but not manufacture using the BCE Patent Rights), use, sell, offer to sell, import or export a Licensed Product or have any of these done on its behalf after the initial binding domains have been identified or discovered by Kaketsuken.

Kaketsuken agrees that it will not practice any Valid Claim of the BCE Patent Rights outside of the scope of the license granted in this Section 5(b) without first obtaining a license from XOMA.

(c) Option. Kaketsuken shall have an option right to use XOMA's *E. coli* cell expression system and practice the BCE Patent Rights to manufacture or have manufactured the Licensed Products on terms to be negotiated in good faith by the Parties.

(d) [\*].

(e) Trade Secrets. Kaketsuken and/or each person or entity, including authorized Third Parties, who has access to the Transferred Materials, the Systems and/or the Source Code or Software (as such terms are defined in Section 8) acknowledges the "trade secret" nature of each and every formula, algorithm or computational method contained therein, as well as XOMA's ownership and prior right to such trade secret information. Kaketsuken shall take reasonable steps to prevent the dissemination of the trade secret information contained therein and shall permit the dissemination of such information only to those persons or entities with a "need to know" such information who acknowledge their obligation to maintain the secrecy of such trade secrets and not to use them for purposes not authorized hereunder. For the avoidance of doubt, Kaketsuken shall have an implied license to the trade secrets described in this Section 5(e) as is reasonably necessary to enjoy the benefits of the licenses otherwise granted in this Agreement.

(f) [\*] each of Kaketsuken and XOMA shall be obligated to keep accurate books and records sufficient to identify with reasonable specificity the uses to which [\*] have been put and the Discovery Products which have been derived from or arose out of, directly or indirectly, the use of [\*].

(g) Limitations on Use of Same Source Materials and Copies. None of XOMA or its Affiliates shall [\*]. Subject only to the foregoing, Kaketsuken acknowledges that XOMA and/or its Affiliates may, on their own behalf or on behalf of one or more Third Parties (x) [\*], and/or (y) undertake competitive activities directed to a Target, including using copies of the Licensed Know-How and/or the Systems.

(h) Retention of Rights by XOMA. XOMA shall retain (i) the ownership and right to use [\*] for itself, its Affiliates or any Third Party to which XOMA or an Affiliate of XOMA licenses or grants rights, as part of a bona fide collaboration, development, commercialization or marketing arrangement, to develop, commercialize, market or distribute Antibody Products, and (ii) the ownership and right to use, sell, license, transfer or otherwise exploit the Licensed Know-How and the Systems, the Source Code or the Software (as such terms are defined in Section 8), [\*], the Licensed Patent Rights and/or any other Patent Right, copyright or other item of intellectual property that covers or claims the Transferred Materials and/or their creation, construction or use. [\*]. Except as otherwise expressly provided in this Agreement, under no circumstances shall a Party hereto, as a result of this Agreement, obtain any ownership interest in or other right to any technology, know-how, patents, patent applications, gene or genomic sequence data or information, products, or biological materials of the other Party, including items owned, controlled

or developed by, or licensed to, the other Party, or transferred by the other Party to said Party, at any time pursuant to this Agreement.

#### Section 6. KAKETSUKEN INVENTIONS; UNBLOCKING LICENSE

Kaketsuken shall, as between Kaketsuken and XOMA, have sole and exclusive ownership of all right, title and interest on a worldwide basis in and to any and all intellectual property rights, including but not limited to all patent rights for any inventions, arising out of or relating to its use or practice of the Transferred Materials (“Inventions”) or any activities contemplated hereunder that are owned by Kaketsuken in accordance with applicable patent law, and shall be free to seek and obtain patent protection, except with respect to [\*], the Discovery Patent Rights or the BCE Patent Rights themselves, for any Inventions; *provided, however*, that, solely to the extent such patent or patent application relating to such Invention contains claims that would cover the use or practice of the Transferred Materials, the Licensed Patent Rights and/or any patent or patent application covering the use of the Systems or would block XOMA or its licensees, partners or collaborators from full enjoyment of the same rights as are licensed hereunder to Kaketsuken, (a) Kaketsuken shall provide written notice of the filing of any such patent application to XOMA, and in the event Kaketsuken elects not to prosecute any such patent application or maintain any resulting patent, XOMA, at its own expense, but with the full assistance of Kaketsuken, shall be free to prosecute such patent application and/or maintain such patent, and (b) Kaketsuken shall be deemed to have granted to XOMA a non-exclusive, fully paid-up, irrevocable, worldwide license, with the right to grant sublicenses, in order for XOMA, and any Third Party working with XOMA, directly or without limitation as a licensee, partner or collaborator, to enjoy the benefit, on its own behalf or on behalf of any Third Party, of the use or practice of the Transferred Materials, the Licensed Patent Rights and/or any patent or patent application covering the use of the Systems, *provided, however*, that such sublicenses by XOMA will be granted to such a Third Party only in the event that such Third Party is obligated to grant a license to XOMA, with the right to sublicense to licensees of XOMA, under any patent of such Third Party to the extent such patent contains claims that would cover the use or practice of the Transferred Materials, the Licensed Patent Rights and/or the Systems by Kaketsuken as provided herein or would block Kaketsuken from full enjoyment of the rights thereto that are licensed hereunder. In the event that, after the Effective Date, Kaketsuken acquires Control of any Patent Rights to which this Section 6 would apply because the invention disclosures in such Patent Rights are covered by the first sentence hereof, then, subject to any limitations and obligations of any written agreement relating to such Patent Rights, Kaketsuken shall, at XOMA’s option, extend to XOMA the same rights to such Patent Rights as are otherwise provided for herein.

#### Section 7. LIMITATIONS ON USE AND MODIFICATION

(a) Certain Transfers. All uses of the Transferred Materials shall initially be performed at Kaketsuken’s facility (Kikuchi Research Center) located at Kyokushi kawabe, Kikuchi-shi, Kumamoto, Japan; *provided, however*, that on not less than thirty (30) days’ prior written notice to XOMA, Kaketsuken may change the location to, or may add an additional location to include, any other site of its selection that is and will remain under its exclusive control, it being understood that XOMA shall have no responsibility hereunder for any such transfer. Any site at

which the Transferred Materials will be used shall be and shall remain accessible to Kaketsuken's employees and consultants only, shall be under the exclusive control of Kaketsuken and shall have reasonable safeguards designed to protect the Transferred Materials from theft, destruction or unauthorized use, it being understood that any such employee or consultant shall agree in writing, prior to being given access thereto, to abide by obligations no less stringent than those contained in this Agreement and to transfer and assign to Kaketsuken all intellectual property rights for any invention arising out of the use of the Transferred Materials, and Kaketsuken shall remain fully responsible to XOMA for the fulfillment by any such employee or consultant of the confidentiality, transfer and assignment obligations as provided therein.

(b) Certain Limitations. Kaketsuken acknowledges, represents and warrants that the transfers provided for by this Agreement arise out of and are part of the Collaboration; *provided, however*, that the use of the Transferred Materials and the practice of the Licensed Patent Rights and any other Patent Rights to which rights are granted pursuant to this Agreement may, subject to the applicable provisions of this Agreement, be used by Kaketsuken for any other purpose including the discovery, development and subsequent commercial sale of any composition of matter in the Field. Notwithstanding the foregoing, the following restrictions shall apply to the Transferred Materials:

(i) Except by XOMA, [\*] may not be altered, modified or copied.

(ii) The Transferred Materials may not be transferred or disposed of to a Third Party; *provided, however*, that [\*].

(iii) Kaketsuken shall not use the Transferred Materials or practice the Licensed Patent Rights and any other Patent Rights to which rights are granted pursuant to this Agreement on behalf of any Third Party, [\*] or otherwise engage in activities not directly associated with Kaketsuken's own internal discovery, research and development programs; *provided, however*, that, so long as the other limitations of this Agreement are satisfied, Kaketsuken may use the Transferred Materials or practice the Licensed Patent Rights and any other Patent Rights covered by this Agreement with respect to any Licensed Product as to which Kaketsuken has either in-licensed or acquired rights from a Third Party where such in-license or grant of rights is for the exclusive development of such Licensed Product or variants thereof by Kaketsuken and the original licensor does not become a Kaketsuken Licensee with respect to such Licensed Product.

(iv) Kaketsuken acknowledges that its rights to use the Transferred Materials are subject to all applicable limitations, restrictions and obligations provided for in the terms of any license or grant of rights from or other agreement with a Third Party the benefit of which is claimed by Kaketsuken.

(v) None of the grants of rights or licenses herein or the use of any of the Transferred Materials extend to or permit Kaketsuken to work with or extend any benefit hereunder to (A) any composition of matter, article of manufacture or Know-How arising out of the unauthorized use of any item of Know-How or practice of any

Patent Right owned or controlled by XOMA or its Affiliates that is also licensed to Kaketsuken or (B) any Third Party who is engaged in such unauthorized use or practice.

#### Section 8. CERTAIN PROVISIONS RELATING TO SOFTWARE

(a) Additional Definitions. For purposes of this Section 8, the following terms shall have the respective meanings indicated below:

- (i) “Applicable Patent Rights” shall mean (A) in the case where XOMA is the grantor of rights, claims of patents that (I) are now or hereafter acquired, owned by or assigned to XOMA and (II) cover subject matter contained in the Source Code or the Software, and (B) in the case where Kaketsuken is the grantor of rights, claims of patents that (I) are now or hereafter acquired, owned by or assigned to Kaketsuken and (II) cover subject matter contained in the Covered Code or the Covered Software.
- (ii) “Covered Code” shall mean the Source Code and any Modifications to the Source Code made by Kaketsuken or any person or entity acting on Kaketsuken’s behalf.
- (iii) “Covered Software” shall mean the Software and any Modifications to the Software made by Kaketsuken or any person or entity acting on Kaketsuken’s behalf.
- (iv) “Modifications” shall mean any addition to, deletion from and/or other change to the substance and/or structure of the Source Code or the Software designated in item A.1 of Schedule 1.51 as non-encrypted. When code is released as a series of files, a Modification is (A) any addition to or deletion from the contents of a file containing the Covered Code or the Covered Software and/or (B) any new file or other representation of computer program statements that contains any part of the Covered Code or the Covered Software.
- (v) “Software” shall mean the software, programs and/or computer instruction sets, other than the Source Code, consisting of the versions thereof existing and deployed at XOMA as of the Effective Date and more fully described in item A.1 of Schedule 1.51 and any changed or modified versions thereof that correct significant defects contained in the Software as of the Effective Date (“Corrected Software”). Expressly excluded from the definition of Software are (A) other programs, software and/or computer instructions that XOMA derives from such programs, software and/or computer instructions or develops, acquires or obtains the right to sublicense during the term of this Section 8, as well as (B) any changed, modified or enhanced versions of the Software (other than Corrected Software).
- (vi) “Source Code” shall mean the human readable form of the Software designated in item A.1 of Schedule 1.51 as non-encrypted that is suitable for modification, including all modules it contains, plus any associated data files, interface definition files, scripts used to control compilation and installation of an executable computer instruction.

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(b) Corrected Software. If, within the first [\*] following the Effective Date, XOMA develops, licenses or acquires any Corrected Software, XOMA shall promptly provide Kaketsuken with a copy thereof. All Corrected Software shall be deemed, in accordance with the terms and conditions of this Section 8 and without payment of additional consideration, to be included in the definition of Software.

(c) Terms and Conditions.

(i) Any reproduction, use or dissemination of any Covered Code or Covered Software, including without limitation, any Modifications thereof, shall be limited to activities undertaken by Kaketsuken employees who are subject to the confidentiality and intellectual property provisions of this Agreement. Notwithstanding the foregoing, Kaketsuken may employ or use Third Parties to make Modifications or use the Covered Code or the Covered Software for purposes reasonably related to Kaketsuken's legitimate use as provided for by this Agreement, including this Section 8. Kaketsuken shall not grant any such Third Party the right to access the Software designated in item A.1 of Schedule 1.51 as non-encrypted or the Source Code unless and until such Third Party executes a written confidentiality agreement that provides, in addition to the other terms and conditions of such agreement, that (A) the Third Party will abide, for XOMA's and Kaketsuken's benefit, by the limitations provided for in this Section 8 and the other provisions of this Agreement, (B) all work will be undertaken by such Third Party in a manner so as to establish that any such work is done as a "work made for hire" and (C) such Third Party will assign any patent rights to Kaketsuken such that they become Applicable Patent Rights.

(ii) Kaketsuken shall retain and reproduce in all copies of the Covered Code and the Covered Software (A) the copyright and other proprietary notices and disclaimers of XOMA as they appear in the Source Code and the Software, respectively, (B) all notices in the Source Code and/or the Software that refer to this Section 8, and (C) to the extent it does not already exist, the notice provided for below:

"Portions Copyright (c) 2005-2009 XOMA Technology Ltd. All Rights Reserved.

"This file contains Source Code or Software or Modifications thereof as defined in and that are subject to a software license and related terms between Kaketsuken and XOMA Development Corporation. You may not use this file except in compliance with that license and those terms. Please obtain a copy of the software license and related terms between Kaketsuken and XOMA by contacting General Manager of Research Department 1, of Kaketsuken, and read it before using this file.

"Unless otherwise stated, these materials are distributed on an 'AS IS' basis, WITHOUT WARRANTY OF ANY KIND, EITHER EXPRESS OR IMPLIED, AND XOMA HEREBY DISCLAIMS ALL SUCH WARRANTIES, INCLUDING WITHOUT LIMITATION, ANY

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WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, QUIET ENJOYMENT OR NON-INFRINGEMENT. Please see the software license and related terms between Kaketsuken and XOMA for the specific language governing rights and limitations under that license and those terms.”

(iii) For any Modifications, Kaketsuken must cause the modified files to carry notices stating that Kaketsuken changed the files and the date of such change.

(iv) Kaketsuken will use commercially reasonable and diligent efforts to protect XOMA’s proprietary interests in and to the Software, the Source Code and XOMA’s Applicable Patent Rights, including, as appropriate, ensuring that there is password protection of any computer or network containing any copies of the Covered Code or the Covered Software. In addition, Kaketsuken will prohibit its employees from disclosing to unauthorized Third Parties the Covered Code or the Covered Software except under the conditions required by this Section 8 and the acknowledgement that the Software and the Source Code constitute Confidential Information of XOMA under this Agreement.

(d) Kaketsuken Exclusive Rights. Kaketsuken shall own all Modifications to the Source Code or the Software designated in item A.1 of Schedule 1.51 as non-encrypted created by Kaketsuken pursuant to this Section 8 and shall have no obligation to share or provide copies or updates thereof to XOMA.

(e) Representations and Warranties Regarding Software and Source Code. XOMA represents and warrants that the Source Code and the Software were made by XOMA employees and constitute a “work made for hire” and were not authored or distributed to Kaketsuken in violation of any agreements between XOMA and any Third Party, including any “open source” licenses.

(f) Limitations on Warranties and Support. XOMA's only obligations to provide to Kaketsuken updates to, revisions to or modifications of any of the Transferred Materials shall be those expressly provided in this Section 8. Kaketsuken shall be responsible for providing, at its cost, any Third Party hardware or software required to deploy and operate the Systems. The Covered Code or the Covered Software may contain in whole or in part pre-release, untested or not fully tested works, may contain errors that could cause failures or loss of data, and may be incomplete or contain inaccuracies. Kaketsuken expressly acknowledges and agrees that use of the Covered Code or the Covered Software, or any portion thereof, is at Kaketsuken's sole and entire risk. UNLESS OTHERWISE STATED, THE SOURCE CODE AND THE SOFTWARE ARE PROVIDED "AS IS" AND WITHOUT WARRANTY, UPGRADES OR SUPPORT OF ANY KIND. UNLESS OTHERWISE STATED, XOMA, ITS LICENSOR(S) AND CONTRIBUTORS (COLLECTIVELY REFERRED TO AS "XOMA" FOR THE PURPOSES OF THIS SECTION 8(f)) EXPRESSLY DISCLAIM ALL WARRANTIES AND/OR CONDITIONS, EXPRESS OR IMPLIED, INCLUDING, BUT NOT LIMITED TO, THE IMPLIED WARRANTIES AND/OR CONDITIONS OF MERCHANTABILITY, OF SATISFACTORY QUALITY, OF FITNESS FOR A PARTICULAR PURPOSE, OF ACCURACY, OF QUIET ENJOYMENT AND OF NONINFRINGEMENT OF THIRD PARTY RIGHTS. XOMA DOES NOT WARRANT AGAINST INTERFERENCE WITH KAKETSUKEN'S ENJOYMENT OF THE COVERED CODE AND THE COVERED SOFTWARE, THAT THE FUNCTIONS CONTAINED IN THE COVERED CODE OR THE COVERED SOFTWARE WILL MEET KAKETSUKEN'S REQUIREMENTS, THAT THE OPERATION OF THE COVERED CODE OR THE COVERED SOFTWARE WILL BE UNINTERRUPTED OR ERROR-FREE, OR THAT DEFECTS IN THE COVERED CODE OR THE COVERED SOFTWARE WILL BE CORRECTED. NO ORAL OR WRITTEN INFORMATION OR ADVICE GIVEN BY XOMA OR ANY XOMA REPRESENTATIVE SHALL CREATE A WARRANTY. Kaketsuken acknowledges that neither the Covered Code nor the Covered Software is intended for use in the operation of nuclear facilities, aircraft navigation, communication systems or air traffic control machines, in which case the failure of the Covered Code or the Covered Software could lead to death, personal injury or severe physical or environmental damage.

(g) Government End Users. Each of the Covered Code and the Covered Software is a "commercial item" as defined in FAR 2.101. Government software and technical data rights in the Covered Code or the Covered Software include only those rights customarily provided to the public as defined in this Section 8. This customary commercial license in technical data and software is provided in accordance with FAR 12.211 (Technical Data) and 12.212 (Computer Software) and, for Department of Defense purchases, DFAR 252.227-7015 (Technical Data — Commercial Items) and 227.7202-3 (Rights in Commercial Computer Software or Computer Software Documentation). Accordingly, all U.S. Government End Users acquire the Covered Code or the Covered Software with only those rights set forth herein.

#### Section 9. UPFRONT FEE

In consideration for the obligation to deliver [\*] in accordance with the [\*] Specifications, the Discovery Know-How relating thereto and the Systems and the transfers and grants of rights

relating to the TAE Technology, Discovery Patent Rights, BCE Patent Rights and [\*], Kaketsuken shall pay XOMA a non-refundable fee as follows:

- (a) Six Million United States Dollars (US\$6,000,000) payable on, or not later than [\*] following, delivery by Kaketsuken of the Verification Notice pursuant to Section 3(c), and
- (b) Two Million United States Dollars (US\$2,000,000) payable following delivery by Kaketsuken of the Verification Notice pursuant to Section 3(c) on the first anniversary of the Effective Date; *provided*, that [\*].

Section 10. MILESTONES

For each Licensed Product, on a Licensed Product-by-Licensed Product basis, Kaketsuken shall pay XOMA the amounts set forth below:

<u>Event</u>	<u>Payment</u>
First dosing in a Phase 1 Trial	[*]
First dosing in a Phase 2 Trial	[*]
First dosing in a Phase 3 Trial	[*]
Acceptance of first filing of BLA	[*]

For the avoidance of doubt, the milestone payments due for each Licensed Product shall be paid only once per each Licensed Product.

Section 11. ROYALTY PAYMENTS

(a) Term. Kaketsuken shall pay XOMA a running royalty on a Licensed Product-by-Licensed Product and country-by-country basis upon the First Commercial Sale of each such Licensed Product in each such country for fifteen (15) years after First Commercial Sale of each such Licensed Product in each such country (the "Royalty Term").

(b) Rate. The royalty obligation hereunder shall be payable at a rate of [\*] of the Net Sales of each Discovery Product for the [\*].

Section 12. REPORTING AND RECORD KEEPING

(a) Milestone Reporting. During the term of this Agreement, Kaketsuken shall within [\*] after the achievement of any milestone event referred to in Section 10, furnish to XOMA a written notice indicating the milestone achieved and, if applicable, the relevant indication, label expansion and/or Regulatory Authority. Milestone payments for each milestone event shall be due simultaneously with Kaketsuken's report under this Section 12(a) for such milestone event.

(b) Royalty Reporting.

(i) All amounts payable to XOMA under Section 11 shall be paid on a [\*] basis. Kaketsuken shall, within [\*] after the end of each [\*], deliver to XOMA a written report of the amount due to XOMA, pursuant to Section 11, for the Net Sales in such calendar quarter, indicating [\*]. Royalty payments for each calendar quarter shall be due simultaneously with Kaketsuken's report under this Section 12(b) for such quarter.

(ii) Kaketsuken shall provide XOMA with a [\*] flash statement of the amount of gross sales of each Licensed Product in the Territory during the applicable [\*]. Kaketsuken shall require any Kaketsuken Licensees to account for their Net Sales and to provide such reports with respect thereto so that Kaketsuken can fulfill the above-mentioned obligations in this Section 12(b).

(iii) Royalties payable on sales in countries other than the United States shall be calculated in accordance with the standard exchange rate conversion practices used by Kaketsuken for financial accounting purposes. If no royalty or payment is due for any royalty period hereunder, Kaketsuken shall so report.

(c) Record Keeping. Kaketsuken shall keep and shall require any Kaketsuken Licensees to keep (all in accordance with GAAP), for at least [\*] after prepared, complete and accurate books and records in sufficient detail to properly reflect all gross sales and Net Sales and to enable the royalties payable hereunder to be determined. Kaketsuken shall include in each agreement with each applicable Kaketsuken Licensee a provision requiring such Kaketsuken Licensee to make reports to Kaketsuken, to keep and maintain records of sales made pursuant to such agreement and to grant access to such records by XOMA's independent registered public accounting firm to the same extent required of Kaketsuken under this Agreement.

(d) [\*].

Section 13. OTHER PAYMENT-RELATED PROVISIONS

(a) Audit. Upon the written request of XOMA, Kaketsuken shall permit an independent registered public accounting firm selected by XOMA and acceptable to Kaketsuken, which acceptance shall not be unreasonably withheld or delayed, to have access, at reasonable times and during normal business hours, to such records of Kaketsuken as may be reasonably necessary to verify the accuracy of a Kaketsuken payment report hereunder; *provided* that such records shall be limited to those prepared since the beginning of the then current calendar year or during the immediately preceding [\*]. Each Party shall use commercially reasonable efforts to schedule all such verifications within [\*] after XOMA makes its written request. All such verifications shall be conducted not more than [\*] in, or with respect to, each calendar year. The report of XOMA's independent registered public accounting firm shall be made available to both Parties. Subject to the Kaketsuken's rights under Section 19(h), in the event XOMA's independent registered public accounting firm concludes that additional amounts were owed to XOMA for such period, the additional amounts shall be paid by Kaketsuken within [\*] of the date XOMA delivers to Kaketsuken such written report so concluding, unless such report contains

manifest error. In the event XOMA's independent registered public accounting firm concludes that there was an overpayment to XOMA during such period, the overpayment shall be repaid by XOMA within [\*] of the date XOMA received such written report so concluding, unless such report contains manifest error. The fees charged by such independent registered public accounting firm shall be paid by XOMA unless such audit discloses a payment deficiency of more than [\*] of the amount due under this Agreement for the period in question, in which case Kaketsuken will bear the full cost of such audit. Each Party agrees that all information subject to review under this Section 13(a), or under any agreement with a Kaketsuken Licensee, is confidential and that XOMA shall cause its independent registered public accounting firm to retain all such information in confidence. XOMA's independent registered public accounting firm shall only report to XOMA as to the computation of royalties or charges and invoices payable under this Agreement, as applicable, and shall not disclose to XOMA any other information of Kaketsuken or any Kaketsuken Licensee.

(b) Taxes. All payments hereunder shall be made free and clear of and without deduction or deferment in respect of any demand, set-off, counterclaim, or other dispute and, so far as is legally possible, such payment will be made free and clear of any taxes imposed by or under the authority of any government or public authority. Kaketsuken shall make any applicable withholding payments due on behalf of XOMA and shall pay such additional amount as may be required to ensure that the net amount received by XOMA will equal the full amount which would have been received by it had not such tax been imposed or withheld. It is confirmed that Kaketsuken shall give XOMA such assistance as may reasonably be necessary to enable or assist XOMA to claim the relief in respect of such withholding tax from Japanese Income Tax under the provision of the Income Tax Convention between Japan and the United States of America.

(c) Blocked Currency. If by Law conversion into United States dollars or transfer of funds of a convertible currency to the United States is restricted or forbidden, the Party owing such payment shall give the Party to which such payment is owed prompt written notice and shall make such payment due under this Agreement through such means or methods as are lawful in such country as the Party to which such payment is owed may reasonably designate. Failing the designation by the Party to which such payment is owed of such lawful means or methods within [\*] after such written notice is given to such Party, the Party owing such payment shall deposit such royalty payment in local currency to the credit of the Party to which such payment is owed in a recognized banking institution designated by such Party, or if none is designated by such Party within the [\*] period described above, in a recognized banking institution selected by the Party owing such payment and identified in a written notice to other Party, and such deposit shall fulfill all obligations of the Party owing such payment to the other Party with respect to such payment.

(d) Interest on Late Payments. Any failure by a Party to make a payment when due shall obligate such Party to pay interest to the receiving Party at a rate equal to [\*] (the "Applicable Interest Rate"). The Applicable Interest Rate shall be calculated from the date payment was due until actually received by the receiving Party based on actual number of days lapsed and a 360-day year.

(e) Method of Payment. Except as provided in Section 13(c), payments to be made by one Party to the other under this Agreement shall be payable in United States dollars and shall be paid by wire transfer in immediately available funds to such bank account as is designated in writing by such Party. Attached hereto as Schedule 13(e) is such bank account information for payments to be made to XOMA hereunder, until such time as XOMA designates a different bank account as provided herein.

(f) Certain Acknowledgements. Kaketsuken acknowledges and agrees that the amount of milestones and royalties due hereunder and the duration of the royalty payments herein have been chosen for the convenience of the Parties as payment for use of the Transferred Materials during the term of this Agreement under the terms and conditions hereof.

#### Section 14. DEVELOPMENT DILIGENCE

Kaketsuken, or as applicable, each Kaketsuken Licensee shall use Commercially Reasonable and Diligent Efforts to actively develop and obtain regulatory approval for Discovery Products and, following such regulatory approval, to maximize Net Sales of such Discovery Product.

#### Section 15. CONFIDENTIALITY

##### (a) Nondisclosure Obligations.

(i) General. Except as otherwise provided in this Section 15, during the term of this Agreement and for a period of [\*] thereafter, or longer if required by any agreement with a Third Party relating to such Confidential Information, each Receiving Party shall maintain the Confidential Information of each Disclosing Party in confidence and use it only for purposes specifically authorized under this Agreement. Upon the expiration or termination of this Agreement, each Party shall promptly inform the other Party in writing if any Confidential Information the other Party received from such Party hereunder is covered by such a Third Party agreement with such Party and if the term of confidentiality for such Confidential Information will extend beyond such [\*] period.

(ii) Limitations. To the extent it is reasonably necessary or appropriate to fulfill its obligations or exercise its rights under this Agreement and subject to advance written notification to the Disclosing Party: (A) a Party may disclose Confidential Information it is otherwise obligated not to disclose under this Section 15(a), to its Affiliates, Kaketsuken Licensees, consultants, outside contractors and clinical investigators, on a strict need-to-know basis for the purposes contemplated by this Agreement and on condition that such entities or persons agree to keep the Confidential Information confidential for the same time periods and to the same extent as such Party is required to keep the Confidential Information confidential hereunder; and (B) a Party or any Kaketsuken Licensees may disclose, using appropriate measures to preserve confidentiality, such Confidential Information to government or other regulatory authorities to the extent that such disclosure is reasonably necessary to obtain authorizations to conduct clinical trials of, and/or to commercially market, Licensed Products. Furthermore, a Receiving Party may request permission from the Disclosing Party to disclose such Confidential Information to the extent

that such disclosure is reasonably necessary to obtain patents which such Receiving Party is permitted to obtain hereunder, which permission shall not be unreasonably withheld or delayed. In addition, so long as such disclosure is subject to confidentiality undertakings at least as stringent as those in this Agreement, XOMA may disclose data including or comprising Confidential Information of Kaketsuken to actual or prospective collaborators or licensees for purposes of demonstrating, presenting or otherwise promoting XOMA's technologies, expertise and/or capabilities with respect to the TAE Technology, the Discovery Know-How, the Discovery Patent Rights, the Systems and/or collections of polynucleotides encoding Antibodies constructed or to be constructed by XOMA.

(iii) Required Disclosure. A Receiving Party may disclose Confidential Information pursuant to interrogatories, requests for information or documents, subpoena, civil investigative demand issued by a court or governmental agency or as otherwise required by Law; *provided, however*, that the Receiving Party shall notify the Disclosing Party promptly upon receipt thereof, giving (where practicable) the Disclosing Party sufficient advance notice to permit it to oppose, limit or seek confidential treatment for such disclosure; and *provided, further*, that the Receiving Party shall furnish only that portion of the Confidential Information which it is advised by counsel is legally required whether or not a protective order or other similar order is obtained by the Disclosing Party.

(b) Injunctive Relief. The Parties hereto understand and agree that remedies at law may be inadequate to protect against any breach of any of the provisions of this Section 15 by either Party or their employees, agents, officers or directors or any other person acting in concert with it or on its behalf. Accordingly, each Party shall be entitled to the granting of injunctive relief by a court of competent jurisdiction against any action that constitutes any such breach of this Section 15.

(c) Terms of this Agreement. The terms of this Agreement shall be treated as the Confidential Information of Kaketsuken and XOMA and shall not be disclosed without the written permission of XOMA or Kaketsuken, as the case may be, except (i) as required by securities or other applicable laws or stock exchange rules, (ii) to a Party's accountants, attorneys and financial and other professional advisors, (iii) so long as such disclosure is subject to confidentiality undertakings at least as stringent as those in this Agreement, to actual or prospective collaboration partners, acquirers, investors or underwriters, or (iv) as otherwise provided herein. The Parties hereby agree to the release of a press release in the form attached hereto as Schedule 15(c) upon full execution of this Agreement and that the fact of the consummation of this Agreement, as well as the terms that are expressly described in such press release, shall be deemed to be in the public domain. If either Party desires to release a separate announcement relating to this Agreement, it shall first allow the other Party [\*] to approve in writing such proposed announcement; *provided* that such approval shall not be unreasonably withheld or delayed. Nothing herein shall be deemed to prohibit, restrict or limit any disclosure that is consistent in all material respects with prior disclosures.

#### Section 16. REPRESENTATIONS AND WARRANTIES

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(a) Representations, Warranties and Covenants of Kaketsuken. Kaketsuken represents and warrants to and covenants with XOMA that:

(i) Kaketsuken is duly organized, validly existing and in good standing under the laws of Japan;

(ii) Kaketsuken has the full legal right, authority and power to enter into this Agreement, and to extend the rights and licenses granted to XOMA in this Agreement;

(iii) Kaketsuken has taken all necessary action to authorize the execution, delivery and performance of this Agreement;

(iv) upon the execution and delivery of this Agreement, this Agreement shall constitute a valid and binding obligation of Kaketsuken, enforceable in accordance with its terms, except as enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' and contracting Parties' rights generally and except as enforceability may be subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law); and

(v) the performance of Kaketsuken's obligations under this Agreement will not conflict with Kaketsuken's organizational documents or result in a breach of any agreements, contracts or other arrangements to which it is a Party or violate any court or administrative order by which it is bound.

(b) Representations, Warranties and Covenants of XOMA. XOMA represents and warrants to and covenants with Kaketsuken that:

(i) XOMA is duly organized, validly existing and in good standing under the laws of Delaware;

(ii) XOMA has the full legal right, authority and power to enter into this Agreement, and to extend the rights and licenses granted to Kaketsuken in this Agreement;

(iii) XOMA has taken all necessary corporate action to authorize the execution, delivery and performance of this Agreement;

(iv) upon the execution and delivery of this Agreement, this Agreement shall constitute a valid and binding obligation of XOMA, enforceable in accordance with its terms, except as enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' and contracting Parties' rights generally and except as enforceability may be subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law);

(v) the performance of its obligations under this Agreement will not conflict with XOMA's organizational documents or result in a breach of any agreements, contracts or other arrangements to which it is a Party or violate any court or administrative order by which it is bound;

(vi) Each of Schedule 1.5, Schedule 1.19, Schedule 1.51, Schedule 1.58 and Schedule 1.61 is a complete and correct list of all BCE Patent Rights, Discovery Patent Rights, System Patent Rights, TAE Patent Rights and [\*], in each case Controlled by XOMA as of the Effective Date; and

(vii) XOMA will, and will cause its Affiliates to, (A) [\*], unless otherwise consented to by Kaketsuken in writing *provided* that in the event of a voluntary or involuntary bankruptcy filing by or against any Third Party licensor of [\*], XOMA or any Affiliate of XOMA shall exercise its election as Licensee pursuant to Section 365(n)(1)(B) of the Bankruptcy Code or take other steps available under applicable foreign law to preserve its interest as licensee, and (B) maintain the licenses granted to XOMA by certain of its Affiliates pursuant to agreements in effect on the Effective Date that are related to the sublicenses or other intellectual property rights (including a covenant not to sue) under the [\*] granted to Kaketsuken hereunder, unless otherwise consented to by Kaketsuken in writing, *provided* that in the event of a voluntary or involuntary bankruptcy filing by or against any licensor of such licenses granted to XOMA by certain of its Affiliates, XOMA shall exercise its election as Licensee pursuant to Section 365(n)(1)(B) of the Bankruptcy Code or take other steps available under applicable foreign law to preserve its interest as licensee.

(viii) XOMA will notify Kaketsuken [\*] of any termination notice received by XOMA or any of its Affiliates under any of the [\*] or of any circumstance of which XOMA is informed, including insolvency of a Third Party licensor of a [\*], which constitutes, or with the giving of notice or lapse of time would constitute, a cause for termination of a [\*].

(c) Limited Liability. EXCEPT AS SPECIFICALLY SET FORTH IN THIS AGREEMENT, NEITHER KAKETSUKEN NOR XOMA WILL BE LIABLE WITH RESPECT TO ANY MATTER ARISING UNDER THIS AGREEMENT UNDER ANY CONTRACT, NEGLIGENCE, STRICT LIABILITY OR OTHER LEGAL OR EQUITABLE THEORY FOR ANY PUNITIVE, EXEMPLARY, INCIDENTAL OR CONSEQUENTIAL DAMAGES OR LOST PROFITS.

#### Section 17. INDEMNITY

(a) Kaketsuken Indemnity Obligations. Subject to Section 17(c), Kaketsuken agrees to defend, indemnify and hold XOMA, its Affiliates and their respective employees, directors, officers and agents harmless from all claims, losses, damages or expenses (including reasonable attorneys' fees and costs of litigation) arising as a result of (i) any use of the Transferred Materials; (ii) actual or asserted violations of any applicable law or regulation by Kaketsuken, any Kaketsuken Licensees and their respective Affiliates by virtue of which any Licensed Products

manufactured, distributed or sold by Kaketsuken, any Kaketsuken Licensees or their respective Affiliates pursuant to this Agreement shall be alleged or determined to be adulterated, misbranded, mislabeled or otherwise not in compliance with any applicable law or regulation; (iii) claims for bodily injury, death or property damage attributable to use of the Transferred Materials, the manufacture, distribution, sale or use of any Licensed Products by Kaketsuken, any Kaketsuken Licensees or their respective Affiliates; (iv) a recall of a Licensed Product manufactured, distributed or sold by Kaketsuken, any Kaketsuken Licensees or their respective Affiliates ordered by a governmental agency or required by a confirmed Licensed Product failure as reasonably determined by the Parties hereto; or (v) Kaketsuken's breach of any of its representations, warranties or covenants hereunder.

(b) XOMA Indemnity Obligations. Subject to Section 17(c), XOMA agrees to defend, indemnify and hold Kaketsuken, its Affiliates and their respective employees, directors, officers and agents harmless from all claims, losses, damages or expenses (including reasonable attorneys' fees and costs of litigation) arising as a result of XOMA's breach of any of its representations, warranties or covenants hereunder.

(c) Limitation on Indemnity Obligations. Neither Party, its Affiliates or their respective employees and agents shall be entitled to the indemnities set forth in Sections 17(a) or 17(b) respectively, to the comparative extent the claim, loss, damage or expense for which indemnification is sought was caused by a grossly negligent, reckless or intentional act or omission by such Party, its directors, officers, employees or authorized agents.

(d) Procedure. If a Party or any of its Affiliates or their respective employees or agents (collectively, the "Indemnitee") intends to claim indemnification under this Section 17, the Indemnitee shall promptly notify the other Party (the "Indemnitor") of any loss, claim, damage, liability or action in respect of which the Indemnitee intends to claim such indemnification, and the Indemnitor shall assume the defense thereof with counsel selected by the Indemnitor and reasonably acceptable to the Indemnitee; *provided, however*, that an Indemnitee shall have the right to retain its own counsel, with the fees and expenses to be paid by the Indemnitee, if representation of such Indemnitee by the counsel retained by the Indemnitor would be inappropriate due to actual or potential differing interests between such Indemnitee and any other Party represented by such counsel in such proceedings. The Indemnitor shall have the right to settle or compromise any claims for which it is providing indemnification under this Section 17; *provided* that the consent of the Indemnitee (which shall not be unreasonably withheld or delayed) shall be required in the event any such settlement or compromise would adversely affect the interests of the Indemnitee. The indemnity agreement in this Section 17 shall not apply to amounts paid in settlement of any loss, claim, damage, liability or action if such settlement is effected without the consent of the Indemnitor. The failure to deliver notice to the Indemnitor within a reasonable time after the commencement of any such action, if prejudicial to the Indemnitor's ability to defend such action, shall relieve such Indemnitor of any liability to the Indemnitee under this Section 17 resulting from such failure, but the omission so to deliver notice to the Indemnitor will not relieve it of any liability that it may have to any Indemnitee otherwise than under this Section 17. The Indemnitee under this Section 17, its employees and agents, shall cooperate fully with

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the Indemnitor and its legal representatives in the investigation of any action, claim or liability covered by this indemnification.

(e) Defense of Infringement Claims. If a Third Party brings suit against Kaketsuken or any Kaketsuken Licensee alleging that Research and Development or Commercialization of Licensed Product or any other activity under this Agreement infringes the intellectual property rights of others, XOMA shall, to the extent requested by Kaketsuken and at Kaketsuken's cost and expense, cooperate with Kaketsuken's defense of the suit and shall execute all documents and take all other actions, which may reasonably be required in connection with the defense.

#### Section 18. EXPIRATION AND TERMINATION

(a) Term of Agreement. The term of this Agreement shall commence on the Effective Date and shall continue until the payment by Kaketsuken and receipt by XOMA of the last amount to be paid by Kaketsuken to XOMA pursuant to the terms hereof.

(b) Events of Default.

(i) An "Event of Default" by either Party shall have occurred upon (i) the occurrence of a breach of this Agreement if such Party fails to remedy such breach within sixty (60) days after written notice thereof by the non-breaching Party (ten (10) business days in the event of a Party's failure to make a payment required hereunder) or, if remediation of such breach (other than a payment breach) within sixty (60) days is not practicable, if such Party fails to commence and diligently pursue such remediation during such sixty (60) day period, or (ii) the commencement of any proceeding in or for bankruptcy, insolvency, dissolution or winding up by or against such Party that is not dismissed or otherwise disposed of within sixty (60) days thereafter.

(ii) In partial consideration for the grant of rights hereunder, except to the extent the following is unenforceable under the applicable laws of a particular jurisdiction where a patent within the Patent Rights licensed hereunder is pending or a patent within such Patent Rights issued, Kaketsuken agrees that, except to the extent compelled to do so by legal process and subject to any specific contractual obligations of Kaketsuken existing on the Effective Date in circumstances constituting, in the reasonable, written opinion of counsel to Kaketsuken, a breach thereof, it will not contest, direct another to contest or knowingly assist another in contesting the validity or enforceability of any of the Patent Rights licensed hereunder. The Parties agree that this covenant is a material term of this Agreement, and breach of this covenant will constitute a breach of this Agreement.

(c) Effect of an Event of Default. In the event of an Event of Default, the non-defaulting Party shall have the right, at its option exercisable in its sole discretion, in addition to any other rights or remedies available to it at law or in equity and subject to the limitations set forth in Sections 16(c) and 19(h) hereof, to, by written notice to the other Party, deem that such Party has terminated this Agreement in its entirety.

(d) Kaketsuken's Right of Termination. Kaketsuken shall have the right to terminate this Agreement for any reason upon at least thirty (30) days' prior written notice to XOMA at any time after payment of the fee of Eight Million United States Dollars (US\$8,000,000) pursuant to Section 9, in which case:

(i) all licenses granted by XOMA to Kaketsuken under this Agreement shall immediately terminate,

(ii) Kaketsuken shall promptly return to XOMA all the Transferred Materials and Confidential Information disclosed by XOMA hereunder, and thereafter shall not use them, and

(iii) any Licensed Product identified prior to such termination shall be subject to milestone and royalty payment obligations and its related obligations provided for in Sections 10, 11 and 12.

(e) Effect of Expiration or Termination of Agreement. The expiration or termination of this Agreement shall not relieve the Parties of any obligation accruing prior to such expiration or termination. In no way limiting the generality of the foregoing, the provisions of Sections 1, 3(c)(ii), 5(e), 5(h), 6, 10, 11, 12, 13, 15, 16, 17, 18(e) and 19 shall survive the expiration or termination of this Agreement. For avoidance of doubt, any payment due XOMA that are accrued prior to such expiration or termination date shall be immediately due and payable to XOMA.

#### Section 19. MISCELLANEOUS

(a) Force Majeure. Neither Party shall be held liable or responsible to the other Party nor be deemed to have defaulted under or breached this Agreement for failure or delay in fulfilling or performing any obligation under this Agreement when such failure or delay is caused by or results from causes beyond the reasonable control of the affected Party, including but not limited to fire, floods, embargoes, war, acts of war (whether war is declared or not), insurrections, riots, civil commotions, strikes, lockouts or other labor disturbances, acts of God or acts, omissions or delays in acting by any governmental authority; *provided, however*, that the Party so affected shall use commercially reasonable efforts to avoid or remove such causes of nonperformance, and shall continue performance hereunder with reasonable dispatch whenever such causes are removed. Either Party shall provide the other Party with prompt written notice of any delay or failure to perform that occurs by reason of force majeure. The Parties shall mutually seek a resolution of the delay or the failure to perform as noted above.

(b) Assignment. This Agreement may not be assigned or otherwise transferred, in whole or in part, by either Party without the consent of the other Party *provided, however*, that either Kaketsuken or XOMA may, without such consent, assign its rights and obligations under this Agreement (i) to any Affiliate, or (ii) in connection with a merger, consolidation or sale of such portion of a Party's assets that includes rights under this Agreement to an unrelated Third Party; *provided, further*, that such Party's rights and obligations under this Agreement shall be assumed by its successor in interest in any such transaction and shall not be transferred separate from all or substantially all of its other business assets, including those business assets that are

the subject of this Agreement, and *provided, further*, that no such assignment shall be permitted without such consent in the event of any such merger, consolidation or sale of assets resulting in a Change of Control of Kaketsuken to any Third Party. Any purported assignment in violation of the preceding sentence shall be void. Any permitted assignee shall assume all obligations of its assignor under this Agreement, unless the Parties otherwise agree; *provided, however*, that this section will not relieve the assignor from any of its obligations as a surety even after the assignment.

(c) Bankruptcy. All rights and licenses granted under this Agreement by one Party to the other Party are, and shall otherwise be deemed to be, for purposes of Section 365(n) of Title 11 of the United States Code (the "Bankruptcy Code"), licenses of rights to "intellectual property" as defined under Section 101(35A) of the Bankruptcy Code. The Parties agree that each Party under this Agreement shall retain and may fully exercise all of its rights and elections under the Bankruptcy Code in the event of a bankruptcy by or against the other Party, subject to Section 16(b). Upon any filing for bankruptcy protection or of a bankruptcy petition by or against either Party, such Party shall, without unnecessary delay, perform all reasonably necessary procedures under any then-applicable laws, including but not limited to Section 365(n) of the Bankruptcy Code, to protect and preserve all rights and licenses granted to the other Party hereunder, including without limitation exercising the election under Section 365(n)(1)(B) to retain all rights to such intellectual property under the applicable license, agreement and law. Notwithstanding any provision contained in this Agreement to the contrary and without limiting the foregoing, if any bankruptcy action takes place with respect to XOMA or an Affiliate of XOMA, and the trustee in bankruptcy of XOMA or an Affiliate of XOMA, or XOMA or an Affiliate of XOMA as a debtor-in-possession, rejects this Agreement or any License granted hereunder or in connection herewith by obtaining entry of an order of Bankruptcy Court authorizing such rejection, Kaketsuken may, pursuant to Section 365(n) of the Bankruptcy Code, retain and enforce any and all rights hereunder and under any License granted hereunder or in connection herewith to the maximum extent permissible by law. The Parties further agree that in the event of the commencement of a bankruptcy proceeding by or against one Party under the Bankruptcy Code, the other Party, to the extent permitted under applicable Laws, shall be entitled to complete access to any such intellectual property pertaining to the rights granted in the licenses hereunder of the Party by or against whom a bankruptcy proceeding has been commenced and all embodiments of such intellectual property.

(d) Severability. Each Party hereby agrees that it does not intend to violate any public policy, Law, treaty or decision of any government agency or executive body thereof of any country or community or association of countries. Should one or more provisions of this Agreement be or become invalid, the Parties hereto shall substitute, by mutual consent, valid provisions for such invalid provisions which valid provisions in their economic effect are sufficiently similar to the invalid provisions that it can be reasonably assumed that the Parties would have entered into this Agreement with such valid provisions in lieu of such invalid provisions. In case such valid provisions cannot be agreed upon, the invalidity of one or several provisions of this Agreement shall not affect the validity of this Agreement as a whole, unless the invalid provisions are of such essential importance to this Agreement that it is to be reasonably assumed that the Parties would not have entered into this Agreement without the invalid provisions.



(f) Applicable Law. This Agreement shall be governed by and construed in accordance with the laws of the State of California, without reference to the conflicts of law principles thereof.

(g) Forum Selection; Consent to Jurisdiction. Subject to Section 19(h), any litigation based hereon, or arising out of, under, or in connection with this Agreement, shall be brought and maintained exclusively in the state or federal courts located within San Francisco, the State of California. The Parties hereby expressly and irrevocably submit to the jurisdiction of the courts located within San Francisco, the State of California for the limited purpose of any such litigation as set forth above. The Parties further irrevocably consent to the service of process by registered mail, postage prepaid, or by personal service. The Parties hereby expressly and irrevocably waive, to the fullest extent permitted by law, any objection which it may now or hereafter have to the laying of venue of any such litigation brought in any such court referred to above and any claim that any such litigation has been brought in an inconvenient forum.

(h) Dispute Resolution.

(i) If, prior to the end of the [\*] period referred to in Section 3(a)(i) (or, as applicable, Section 3(a)(ii)), Kaketsuken notifies XOMA in writing that it has determined that [\*] (or, as applicable, any repaired or replacement collection of polynucleotides described in Section 3(a)(ii)) is not in accordance with the [\*] Specifications, then XOMA shall, as soon as reasonably practicable following receipt by XOMA of such notice, provide such data as is reasonably necessary to make such determination to a mutually acceptable independent Third Party, which shall review such data, under confidentiality, for the sole purpose of making a final and binding determination as to whether [\*] (or, as applicable, such repaired or replacement collection of polynucleotides) is in accordance with the [\*] Specifications. If, following its review, such Third Party determines that [\*] (or, as applicable, such repaired or replacement collection of polynucleotides) is not in accordance with the [\*] Specifications, then [\*]. If, following its review, such Third Party determines that [\*] (or, as applicable, such repaired or replacement collection of polynucleotides) is in accordance with the [\*] Specifications, then the other provisions of this Agreement shall continue to apply. The Party against which the Third Party reviewer rules shall bear all costs of the Third Party review.

(ii) In the event of any controversy or claim arising out of or relating to this Agreement not expressly covered by Section 19(h)(i), the Parties hereby agree that they will first attempt in good faith to resolve such controversy or claim promptly by negotiations. If such a controversy or claim should arise hereunder, the matter shall be referred to the Representatives. If the matter has not been resolved within [\*] of the first meeting of the Representatives (which period may be extended by mutual agreement) concerning such matter, either Party may initiate arbitration by giving notice to that effect to the other Party simultaneously with filing a notice with the International Chamber of Commerce or its successor organization (“ICC”) in accordance with its International Arbitration Rules. Such dispute shall then be settled by arbitration in New York, New York, to be conducted in the English language and in accordance with the International Arbitration

Rules of the ICC or other rules agreed to by the Parties, by a panel of three neutral arbitrators who shall be selected by the Parties using the procedures for arbitrator selection of the ICC.

(A) The panel shall render its decision and award, including a statement of reasons upon which such award is based, within [\*] after the arbitration hearing. The decision of the panel shall be determined by majority vote among the arbitrators, shall be in writing and shall be binding upon the Parties, final and non-appealable. Judgment upon the award rendered by the panel may be entered in any court having jurisdiction thereof in accordance with Section 19(g).

(B) Except as provided in Section 19(h)(iii), the procedures specified in this Section 19(h) shall be the sole and exclusive procedures for the resolution of disputes between the Parties arising out of or relating to this Agreement; *provided* that a Party, without prejudice to the above procedures, may seek injunctive relief or other provisional judicial relief if in its sole judgment such action is necessary to avoid irreparable damage. Despite such actions seeking injunctive or other provisional judicial relief, the Parties will continue to participate in good faith in the procedures specified in this Section 19(h).

(C) The arbitrators shall issue with the rulings a written determination as to how the fees and expenses of the arbitration, along with the reasonable legal fees and expenses of each Party (including all attorneys' fees, witness fees and expenses), shall be allocated between the Parties. The arbitrators shall allocate such fees and expenses in a way that bears a reasonable relationship to the outcome of the arbitral proceeding, with the Party prevailing on more issues, or issues of greater value or gravity, recovering a relatively larger share of its legal fees and expenses.

(iii) Without limiting or otherwise restricting the Parties' respective rights and obligations expressly set forth in the other provisions of this Agreement, the Parties agree that any dispute between them over the inventorship, ownership, validity, enforceability or infringement of any Patent Rights related to the Collaboration (including without limitation all Patent Rights in respect of or arising out of the use of the Transferred Materials) and Controlled by either Party that cannot be resolved between them after following the procedures set forth in the first two sentences of Section 19(h)(ii) shall be presented only to a court of competent jurisdiction for resolution pursuant to Section 19(g).

(iv) The application of the United Nations Convention on Contracts for the International Sale of Goods is expressly excluded.

(i) Entire Agreement. This Agreement, together with the schedules, exhibits and appendices hereto and any confidentiality agreement(s) executed in contemplation of this Agreement, contains the entire understanding of the Parties with respect to the subject matter hereof. All express or implied agreements and understandings, either oral or written, heretofore made are

expressly merged in and made a part of this Agreement. This Agreement may be amended, or any term hereof modified, only by a written instrument duly executed by both Parties hereto.

(j) Headings. The captions to the several Sections hereof and Schedules hereto are not a part of this Agreement, but are merely guides or labels to assist in locating and reading the several Sections hereof and Schedules hereto.

(k) No Partnership. It is expressly agreed that the relationship between Kaketsuken, on the one hand, and XOMA, on the other hand, shall not constitute a partnership, joint venture or agency. Neither Kaketsuken, on the one hand, nor XOMA, on the one hand, shall have the authority to make any statements, representations or commitments of any kind, or to take any action, which shall be binding on the other, without the prior consent of the other Party to do so.

(l) Exports. The Parties acknowledge that the export of technical data, materials or products is subject to the exporting Party receiving any necessary export licenses and that the Parties cannot be responsible for any delays attributable to export controls which are beyond the reasonable control of either Party. Kaketsuken and XOMA agree not to export or re-export, directly or indirectly, any information, technical data, the direct product of such data, samples or equipment received or generated under this Agreement in violation of any applicable export control laws or governmental regulations. Kaketsuken and XOMA agree to obtain similar covenants from their licensees, sublicensees, or corporate partners, as the case may be, and contractors with respect to the subject matter of this Section 19(l).

(m) Waiver. The waiver by either Party hereto of any right hereunder or of a breach by the other Party shall not be deemed a waiver of any other right hereunder or of any other breach or failure by said other Party whether of a similar nature or otherwise.

(n) Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

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IN WITNESS WHEREOF, the undersigned parties have agreed to the foregoing as of the date first written above.

THE CHEMO-SERO-THERAPEUTIC RESEARCH INSTITUTE

By: \_\_\_\_\_  
Name: Dr. Hiroshi Mizokami  
Title: Executive Director

XOMA DEVELOPMENT CORPORATION

By: \_\_\_\_\_  
Name: Christopher J. Margolin  
Title: Vice President, General Counsel and  
Secretary

Bacterial Cell Expression Patent Rights**A. Title: Modular Assembly of Antibody Genes, Antibodies Prepared Thereby and Use**Inventors: Robinson, Liu, Horwitz, Wall, Better

1) Based on PCT/US86/02269, which is a continuation-in-part of U.S. Application No. 06/793,980 filed November 1, 1985 (abandoned).

<u>COUNTRY</u>	<u>APPLICATION NO.</u>	<u>PATENT NO.</u>
Australia	65981/86	AU 606,320
Denmark	3385/87	DK 175680
Canada	521,909	Abandoned
Europe	86906676.1	0247091 Abandoned
Europe	92115754.1	Abandoned
Japan	505887/1986	Abandoned
Taiwan	75105650	51922
*United States	06/793,980	Abandoned
*United States	U.S. National Phase of PCT/US86/02269	Abandoned

\* Cases abandoned in favor of a continuing application.

2) Based on PCT/US88/02514, which corresponds to U.S. Application No. 07/077,528, which is a continuation-in-part PCT/US86/02269 (abandoned), which is a continuation-in-part of U.S. Application No. 06/793,980 (abandoned).

<u>COUNTRY</u>	<u>APPLICATION NO.</u>	<u>PATENT NO.</u>
Australia	23244/88	AU 632,462
Canada	572,398	CA 1,341,235
Denmark	192/90	DK 174824
Denmark	200301155	DK 175654
Denmark	200301156	DK 175581
Europe	EP 88907510.7	EP 0371998
Austria	EP 88907510.7	AT 0102249
Belgium	EP 88907510.7	BE 0371998
France	EP 88907510.7	FR 0371998
Germany	EP 88907510.7	DE 3888186.1
Italy	EP 88907510.7	IT 0371998
Luxembourg	EP 88907510.7	LU 0371998
Netherlands	EP 88907510.7	NL 0371998
Sweden	EP 88907510.7	SE 0371998
Switzerland/Liechtenstein	EP 88907510.7	CH 0371998

United Kingdom	EP 88907510.7	GB 0371998
Europe	EP 93100041.8	EP 0550400
Austria	EP 93100041.8	AT0140266E
Belgium	EP 93100041.8	BE 0550400
France	EP 93100041.8	FR 0550400
Germany	EP 93100041.8	DE 3855421.6
Italy	EP 93100041.8	IT 0550400
Luxembourg	EP 93100041.8	LU 0550400
Netherlands	EP 93100041.8	NL 0550400
Sweden	EP 93100041.8	SE 0550400
Switzerland/Liechtenstein	EP 93100041.8	CH 0550400
United Kingdom	EP 93100041.8	GB 0550400
Europe	EP 95119798.7	EP 0731167
Austria	EP 95119798.7	AT 0197315
Belgium	EP 95119798.7	BE 0731167
France	EP 95119798.7	FR 0731167
Germany	EP 95119798.7	DE 3856440.8
Italy	EP 95119798.7	IT 0731167
Luxembourg	EP 95119798.7	LU 0731167
Netherlands	EP 95119798.7	NL 0731167
Sweden	EP 95119798.7	SE 0731167
Switzerland/Liechtenstein	EP 95119798.7	CH 0731167
United Kingdom	EP 95119798.7	GB 0731167
Japan	506481/88	JP 2991720
*United States	07/077,528	

\* Cases abandoned in favor of a continuing application.

- 3) Based on U.S. Application No. 07/501,092 filed March 29, 1990, which is a continuation-in-part of U.S. Application No. 07/077,528 (Modular Assembly of Antibody Genes, Antibodies Prepared Thereby and Use; Robinson, Liu, Horwitz, Wall, Better) and of U.S. Application No. 07/142,039 (Novel Plasmid Vector with Pectate Lyase Signal Sequence; Lei, Wilcox).

<u>COUNTRY</u>	<u>APPLICATION NO.</u>	<u>PATENT NO.</u>
*United States	07/501,092	Abandoned
*United States	07/870,404	Abandoned
*United States	07/987,555	Abandoned
*United States	08/020,671	Abandoned
United States	08/235,225	US 5,618,920
United States	08/299,085	US 5,595,898
United States	08/450,731	US 5,693,493
United States	08/466,203	US 5,698,417

United States	08/467,140	US 5,698,435
United States	08/472,691	US 6,204,023
*United States	09/722,315	Abandoned
*United States	09/722,425	Abandoned
*United States	10/040,945	Abandoned
United States	11/582,563	Abandoned

\* Cases abandoned in favor of a continuing application.

**B. Title: Novel Plasmid Vector with Pectate Lyase Signal Sequence (PelB)**

Inventors: Lei, Wilcox

Based on U.S. Application No. 07/142,039 filed January 11, 1988 and PCT/US89/00077.

<u>COUNTRY</u>	<u>APPLICATION NO.</u>	<u>PATENT NO.</u>
Australia	29377/89	AU 627443
Canada	587,885	CA 1,338,807
Europe	EP 89901763.6	EP 0396612
Austria	EP 89901763.6	AT 0140731
Belgium	EP 89901763.6	BE 0396612
France	EP 89901763.6	FR 0396612
Germany	EP 89901763.6	DE 689 26 882
Italy	EP 89901763.6	IT 0396612
Luxembourg	EP 89901763.6	LU 0396612
Netherlands	EP 89901763.6	NL 0396612
Sweden	EP 89901763.6	SE 0396612
Switzerland/Liechtenstein	EP 89901763.6	CH 0396612
United Kingdom	EP 89901763.6	GB 0396612
Japan	501661/89	JP 2980626
*United States	07/142,039	Abandoned
United States	08/472,696	US 5,846,818
United States	08/357,234	US 5,576,195

\* Cases abandoned in favor of a continuing application.

**C. Title: Methods and Cells for Expression of Recombinant Protein Products (Ara)**

Inventor: Better

Based on PCT/US01/08754, which claims priority to U.S. Provisional Application Nos. 60/192,129 filed March 24, 2000 and 60/192,238 filed March 27, 2000

<u>COUNTRY</u>	<u>APPLICATION NO.</u>	<u>PATENT NO.</u>
Australia	2001249265	AU 2001249265
Canada	2,404,046	2,404,046
Europe	01922467.4	EP 1268823
Austria	01922467.4	AT 1268823
Belgium	01922467.4	BE 1268823
Cyprus	01922467.4	CY 1268823
Denmark	01922467.4	DK 1268823
Finland	01922467.4	FI 1268823
France	01922467.4	FR 1268823
Germany	01922467.4	DE 60131261.9-08
Greece	01922467.4	GR 1268823
Ireland	01922467.4	IE 1268823
Italy	01922467.4	IT 1268823
Luxembourg	01922467.4	LU 1268823
Monaco	01922467.4	MC 1268823
Netherlands	01922467.4	NL 1268823
Portugal	01922467.4	PT 1268823
Spain	01922467.4	ES 1268823
Sweden	01922467.4	SE 1268823
Switzerland	01922467.4	CH 1268823
Turkey	01922467.4	TR 1268823
United Kingdom	01922467.4	GB 1268823
[*]	[*]	[*]
Hong Kong	07021559.5-08109183.0	Pending – Published 1120824A
Japan	2001-570798	Pending – Published 2003-528616
*United States	60/192,129	Abandoned
*United States	60/192,238	Abandoned
United States	09/811,933	US 6,803,210
United States	10/963,414	Abandoned

\* Cases abandoned in favor of a continuing application.

[\*]

Discovery Patent Rights

[\*]

Systems

**A. Materials/Know-How**

[\*]

**B. Patent Rights**

[\*]

Targeted Affinity Enhancement Technology

**A. Materials/Know-How**

[\*]

**B. Patent Rights**

[\*]

[\*]

Verification Tests

[\*]

[\*] Specifications

[\*]

[\*] - Quantities and Additional Information

[\*]

Services

**A. Description of Services to be Performed:**

1. [\*]
2. Technical support for the TAE Technology
3. Technical support for the Systems

**B. Compensation:**

[\*]

Wire Transfer Instructions for XOMA

[\*]

Form of Press Release**XOMA Signs Antibody Discovery Collaboration With Kaketsuken**

BERKELEY, Calif., Nov 3, 2009 (GlobeNewswire via COMTEX News Network) — XOMA Ltd. (Nasdaq:XOMA) and Kaketsuken have entered into a collaboration involving multiple proprietary XOMA antibody research and development technologies, including a new XOMA antibody phage display library, and a suite of integrated information and data management systems. Subject to certain technical verification required under the collaboration agreement, Kaketsuken has agreed to pay XOMA a fee of \$8 million and XOMA will be entitled to milestone payments and royalties on product sales. Founded in 1926 in Japan as the Chemo-Sero-Therapeutic Research Institute, Kaketsuken, a research foundation with current annual revenues of approximately US \$350 million, has blood plasma products, vaccines and therapeutics and is developing therapeutic solutions for infectious, and other diseases.

“Antibody technologies are increasingly important in the development of novel therapeutics for a wide range of diseases so it is essential to find the best technologies and partners to maximize the chances for success,” said Dr. Hiroshi Mizokami, Executive Director of Kaketsuken. “With XOMA’s successful record of antibody candidates and drug development relationships, we are confident that they can provide us with the technologies we need to accelerate our antibody development programs. We look forward to a mutually beneficial relationship.”

The centerpiece of the collaboration is access to a highly diverse antibody phage display library constructed by XOMA. Phage display libraries enable rapid generation and screening of large numbers of candidate antibodies and antibody fragments to select for optimal binding and other characteristics. XOMA’s new, proprietary antibody phage display library is one of a new category of libraries being developed by XOMA scientists to overcome existing limitations in library design by combining very high diversity and “best in class” techniques with XOMA’s proprietary and patent-protected technologies to enable the selection of antibodies with very specific and high affinity binding and potency characteristics to an antigen of choice.

“We are pleased to collaborate with Kaketsuken, an innovator in immunology and developer of the DPT vaccine,” said Steven B. Engle, XOMA’s Chairman and Chief Executive Officer. “This is the third technology collaboration XOMA has initiated this year, which combined are expected to result in fee revenue totaling \$43 million and potential future milestone and royalty payments. We look forward to additional agreements that demonstrate the value of our extensive antibody expertise and increase the return on our research and development investment.”

**About XOMA**

XOMA discovers, develops and manufactures therapeutic antibodies designed to treat inflammatory, autoimmune, infectious and oncological diseases. The Company’s proprietary product pipeline includes XOMA 052, an anti-IL-1 beta antibody, and XOMA 3AB, a biodefense anti-botulism antibody candidate.

In addition to its new category of proprietary antibody phage display libraries, XOMA maintains what it believes to be the world’s largest known collection of commercially available antibody phage display libraries. XOMA’s access to these phage display libraries supplements its proprietary

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libraries to provide itself and its collaborators access to unparalleled diversity of antibody domains.

XOMA has multiple revenue streams resulting from the licensing of its antibody technologies, product royalties, development collaborations, and biodefense contracts. XOMA's technologies have contributed to the success of marketed antibody products, including LUCENTIS(R) (ranibizumab injection) for wet age-related macular degeneration and CIMZIA(R) (certolizumab pegol) for rheumatoid arthritis and Crohn's disease.

The company has a premier antibody discovery and development platform that incorporates leading capabilities in antibody phage display, library construction, proprietary antibody humanization and affinity enhancement and Bacterial Cell Expression (BCE) technologies. BCE is a key breakthrough biotechnology for the discovery and manufacturing of antibodies and other proteins. As a result, more than 50 pharmaceutical and biotechnology companies have signed licenses to XOMA's BCE technology.

In addition to developing its own products, XOMA develops products with premier pharmaceutical companies including Novartis AG, Schering-Plough Research Institute and Takeda Pharmaceutical Company Limited. XOMA has a fully integrated product development infrastructure and a team of approximately 190 employees at its Berkeley, California location. For more information, please visit <http://www.xoma.com>.

The XOMA Ltd. logo is available at  
<http://www.globenewswire.com/newsroom/prs/?pkgid=5960>

#### **Forward-Looking Statements**

Certain statements contained herein concerning product development and capabilities of XOMA's technologies or that otherwise relate to future periods are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based on assumptions that may not prove accurate. Actual results could differ materially from those anticipated due to certain risks inherent in the biotechnology industry and for companies engaged in the development of new products in a regulated market.

These risks, including those related to inability to comply with NASDAQ's continued listing requirements; the declining and generally unstable nature of current economic conditions; the results of discovery research and pre-clinical testing; the timing or results of pending and future clinical trials (including the design and progress of clinical trials; safety and efficacy of the products being tested; action, inaction or delay by the FDA, European or other regulators or their advisory bodies; and analysis or interpretation by, or submission to, these entities or others of scientific data); changes in the status of existing collaborative and licensing relationships; the ability of collaborators, licensees and other third parties to meet their obligations; XOMA's ability to meet the demands of the United States government agency with which it has entered into its government contracts; competition; market demands for products; scale-up and marketing capabilities; availability of additional licensing or collaboration opportunities; international operations; share price volatility; XOMA's financing needs and opportunities; uncertainties regarding the status of biotechnology patents; uncertainties as to the costs of protecting intellectual property; and risks associated with XOMA's status as a Bermuda company, are described in more detail

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in XOMA's most recent filing on Form 10-K and in other SEC filings. Consider such risks carefully when considering XOMA's prospects.

Form of Delivery and Receipt Acknowledgement

XOMA DEVELOPMENT CORPORATION  
2910 Seventh Street  
Berkeley, California 94710

\_\_\_\_\_, 2009

The Chemo-Sero-Therapeutic Research Institute  
(Kaketsuken)  
[address]

Ladies and Gentlemen:

Referring to the Discovery Collaboration Agreement effective as of October 29, 2009 between Kaketsuken ("Kaketsuken") and XOMA Development Corporation ("XOMA"), relating to, among other things, the delivery to Kaketsuken of certain materials, know-how and computer systems, XOMA hereby delivers each of the materials, protocols, software, user manuals and other items listed on the attached Transfer Inventory List.

Kindly acknowledge receipt of the items hereinabove referred to in the space provided below.

Very truly yours,

XOMA (US) LLC

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

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Kaketsuken hereby acknowledges receipt of the items hereinabove referred to.

Dated: \_\_\_\_\_, 2009

THE CHEMO-SERO-THERAPEUTIC RESEARCH INSTITUTE

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

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**Transfer Inventory List**

[\*]

Subsidiaries of the Company

XOMA (Bermuda) Ltd.  
XOMA Ireland Limited  
XOMA Technology Ltd.  
XOMA (US) LLC  
XOMA Development Corporation  
XOMA Limited

Jurisdiction of Organization

Bermuda  
Ireland  
Bermuda  
Delaware  
Delaware  
United Kingdom

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-108306 and 333-151416) pertaining to the XOMA Ltd. 1981 Share Option Plan, the XOMA Ltd. Restricted Share Plan, the XOMA Ltd. Management Incentive Compensation Plan, the XOMA Ltd. 1992 Directors Share Option Plan, the XOMA Ltd. 2002 Director Share Option Plan, the XOMA Ltd. 1998 Employee Share Purchase Plan, and the XOMA Ltd. 2007 CEO Share Option Plan and in the Registration Statements on Form S-3 (Nos. 333-112161 and 333-148342) and the related Prospectuses of XOMA Ltd., of our reports dated March 11, 2010, with respect to the consolidated financial statements of XOMA Ltd., and the effectiveness of internal control over financial reporting of XOMA Ltd. included in this Annual Report (Form 10-K) for the year ended December 31, 2009.

/s/ ERNST & YOUNG LLP  
San Francisco, California  
March 11, 2010

**Certification**  
**Pursuant to Section 302 Of The Sarbanes-Oxley Act Of 2002**  
**(Chapter 63, Title 18 U.S.C. Section 1350(A) And (B))**

I, Steven B. Engle, certify that:

1. I have reviewed this annual report on Form 10-K of XOMA Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f))) for the registrant and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 11, 2010

/s/ STEVEN B. ENGLE

\_\_\_\_\_  
Steven B. Engle  
Chairman, Chief Executive Officer and President

**Certification**  
**Pursuant to Section 302 Of The Sarbanes-Oxley Act Of 2002**  
**(Chapter 63, Title 18 U.S.C. Section 1350(A) And (B))**

I, Fred Kurland, certify that:

1. I have reviewed this annual report on Form 10-K of XOMA Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f))) for the registrant and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 11, 2010

/S/ FRED KURLAND

\_\_\_\_\_  
Fred Kurland  
Vice President, Finance and Chief Financial Officer

**Certification**  
**Pursuant to Section 906 Of The Sarbanes-Oxley Act Of 2002**  
**(Chapter 63, Title 18 U.S.C. Section 1350(A) And (B))**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chapter 63, Title 18 U.S.C. Section 1350(a) and (b)), the undersigned hereby certifies in his capacity as an officer of XOMA Ltd. (the "Company") that the Annual Report of the Company on Form 10-K for the year ended December 31, 2009, fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, and that the information contained in such report fairly presents, in all material respects, the financial condition and results of operations of the Company at the end of and for the periods covered by such Report.

Date: March 11, 2010

/s/ STEVEN B. ENGLE

\_\_\_\_\_  
Steven B. Engle  
Chairman, Chief Executive Officer and President

This certification will not be deemed filed for purposes of Section 18 of the Exchange Act (15 U.S.C. 78), or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

**Certification**  
**Pursuant to Section 906 Of The Sarbanes-Oxley Act Of 2002**  
**(Chapter 63, Title 18 U.S.C. Section 1350(A) And (B))**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Chapter 63, Title 18 U.S.C. Section 1350(a) and (b)), the undersigned hereby certifies in his capacity as an officer of XOMA Ltd. (the "Company") that the Annual Report of the Company on Form 10-K for the year ended December 31, 2009, fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, and that the information contained in such report fairly presents, in all material respects, the financial condition and results of operations of the Company at the end of and for the periods covered by such Report.

Date: March 11, 2010

/s/ FRED KURLAND

\_\_\_\_\_  
Fred Kurland  
Vice President, Finance and Chief Financial Officer

This certification will not be deemed filed for purposes of Section 18 of the Exchange Act (15 U.S.C. 78), or otherwise subject to the liability of that section. Such certification will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.



### **XOMA Reports 2009 and Fourth Quarter Financial Results**

BERKELEY, Calif., March 11, 2010: XOMA Ltd. (Nasdaq: XOMA), a leader in the discovery and development of therapeutic antibodies, today announced its financial results for the full year and fourth quarter of 2009 and provided a general business update.

XOMA had total revenues of \$98.4 million in 2009, compared with \$68.0 million in 2008. XOMA had net income of \$0.6 million, or \$0.00 per share, in 2009 compared with a net loss of \$45.2 million, or \$0.34 per share, in the year ended 2008. In the quarter ended December 31, 2009, XOMA had total revenues of \$21.6 million and net income of \$3.0 million, or \$0.01 per share, compared with revenues of \$36.9 million and net income of \$10.0 million, or \$0.07 per share in the fourth quarter of 2008.

At December 31, 2009, XOMA had cash, cash equivalents and short-term investments of \$23.9 million, compared with \$10.8 million at December 31, 2008. In January and February 2010, XOMA received approximately \$21.0 million in proceeds from financing transactions, after underwriting discounts, expenses and an amendment fee to certain existing warrant holders.

“In 2009, we made significant progress in the XOMA 052 clinical development program through completion of a successful Phase 1 program in Type 2 diabetes and initiation of Phase 2 development. XOMA 052 is a novel anti-inflammatory approach to the treatment of Type 2 diabetes and cardio-metabolic diseases,” said Steven B. Engle, XOMA’s Chairman and Chief Executive Officer. “We expanded the XOMA 052 program beyond our initial focus on diabetes to cardiovascular disease. This expansion is supported by results from our Phase 1 trials demonstrating benefit in biomarkers of cardiovascular disease, *in vivo* studies evaluating XOMA 052 in cardio-metabolic disease models, and studies with other IL-1 targeting agents. Some of these results will be presented at the American College of Cardiology meeting this weekend.

“Also during 2009, we significantly increased revenue from antibody discovery, development and licensing collaborations, including expanded or new agreements with Takeda Pharmaceutical Company Limited, Arana Therapeutics, a subsidiary of Cephalon, Inc., and Kaketsuken, a Japanese research foundation. Our growing biodefense program was expanded to include the development of antibodies to the SARS and H1N1/H5N1 viruses.”

### **Priorities for 2010**

- Report interim results from an 80 patient, Phase 2a trial of XOMA 052 in Type 2 diabetes with 60 patients on active drug and 20 patients on placebo
- Conduct a 325 patient Phase 2b dose-ranging trial of XOMA 052 in Type 2 diabetes
- Pursue a partnership for the development and commercialization of XOMA 052
- Publish results from completed XOMA 052 Phase 1 trials and preclinical studies and present results at medical and scientific meetings
- Pursue new antibody discovery, development and licensing collaborations
- Increase biodefense revenue in support of anti-botulinum toxin antibody development program
- Advance the proprietary preclinical pipeline

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## 2009 Accomplishments

- Successfully completed the XOMA 052 Phase 1 development program in Type 2 diabetes
- Initiated XOMA 052 Phase 2 development program focused on Type 2 diabetes and cardiovascular disease
- Demonstrated statistically significant reduction in the formation of plaque in the aorta with XOMA 052 in *anin vivo* model of atherosclerosis
- Presented results at an international diabetes meeting demonstrating XOMA 052's unique regulatory mechanism of action in regulating IL-1 beta signaling
- Received first U.S. and European patent grants covering XOMA 052
- Advanced novel anti-botulism antibody XOMA 3AB and added new biodefense contracts for development of antibodies to H1N1/H5N1 and SARS viruses
- Earned revenues of \$43.8 million from antibody discovery, development and licensing collaborations and royalty-related revenues of \$29.1 million
- Following the market withdrawal of RAPTIVA® by Genentech, eliminated outstanding term loan with Goldman Sachs Specialty Lending Holdings, Inc., partially through sale of XOMA's royalty interest in LUCENTIS® to Genentech for \$25 million
- Completed a restructuring of the organization in January 2009 which resulted in annualized cost savings of approximately \$27 million

## Additional Fourth Quarter Financial Results

XOMA's total revenues in the fourth quarter of 2009 included \$14.5 million in license and collaborative fees, \$6.8 million in contract and other revenue and \$0.2 million in royalty income. In the fourth quarter of 2008, revenues included \$14.9 million in license and collaborative fees, \$15.7 million in contract and other revenue, and \$6.3 million in royalties.

XOMA's research and development expense for the fourth quarter of 2009 was \$14.7 million, compared with \$20.1 million in the same period of 2008. This decrease was due to reduced personnel costs as a result of the January 2009 workforce reduction, and multiple additional cost control initiatives. Selling, general and administrative expenses in the fourth quarter of 2009 were \$4.8 million compared with \$5.2 million for the same period last year.

Interest expense for the fourth quarter of 2009 was \$0.1 million compared with \$2.0 million for the same period of 2008. This decrease is primarily due to the repayment of the Goldman Sachs loan in September 2009 and a decrease in the average outstanding principal balance of and a reduced interest rate on XOMA's note due to Novartis AG.

## Additional Fiscal Year 2009 Financial Results

XOMA's revenues in the year ended December 31, 2009 included \$43.8 million in license and collaborative fees, \$25.5 million in contract and other revenue and \$29.1 million in royalty income. In the year ended December 31, 2008, revenues included \$16.4 million in license and collaborative fees, \$30.5 million in contract and other revenue, and \$21.1 million in royalties.

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XOMA's research and development expense for the year ended December 31, 2009 was \$58.1 million, compared with \$82.6 million in the year ended December 31, 2008. This decrease was due to reduced personnel costs as a result of the January 2009 workforce reduction, and multiple additional cost control initiatives. Selling, general and administrative expenses in 2009 were \$23.7 million compared with \$24.1 million in 2008.

Interest expense for the year ended December 31, 2009 was \$4.9 million, compared with \$7.0 million in the year ended December 31, 2008. This decrease is primarily due to the repayment of the Goldman Sachs loan in September 2009 and a decrease in the average outstanding principal balance of and a reduced interest rate on the note due to Novartis.

#### **Debt Obligations**

In September 2009, XOMA fully repaid the Goldman Sachs loan, including the outstanding principal balance of \$42.0 million, accrued interest of \$2.4 million and a prepayment premium of \$2.5 million.

With this repayment, XOMA's sole long-term debt obligation at the end of 2009 was the \$13.3 million Novartis note. This note was established to facilitate XOMA's participation in its collaboration with Novartis including the development of HCD 122 which is being evaluated for the treatment of lymphoma in Phase 1a/2 studies. The Novartis loan is secured by XOMA's interest in the collaboration and is due in 2015.

#### **Liquidity and Capital Resources**

Cash provided by operating activities during 2009 was \$7.4 million compared with cash used in operating activities of \$33.0 million during 2008. This change is primarily due to the sale of the LUCENTIS® royalty interest to Genentech and license and collaborative fees.

#### **Guidance**

The company will not be providing guidance on revenues or cash receipts for 2010 so as to best manage its ongoing negotiations for XOMA 052 and technology licensing and in light of general economic and market conditions. The company expects that cash used in operating activities may range from \$45 million to cash neutral or positive.

#### **NASDAQ Update**

As previously announced, in September 2009 XOMA received notice from NASDAQ that for the 30 consecutive business days preceding September 15, 2009 the bid price for its common shares closed below the minimum \$1.00 per share required by NASDAQ's continued listing rules and that XOMA has until March 15, 2010, to regain compliance with this requirement. The company anticipates receiving a letter from NASDAQ on or shortly after March 16, 2010, indicating that it has not regained compliance with this requirement. XOMA intends to request a hearing before the NASDAQ Listing Qualifications Panel (the "Panel"), which request will stay delisting pending the Panel's decision following the hearing. At the hearing, XOMA intends to request continued listing based on a plan for regaining compliance. Although the Panel has the authority to grant the company up to an additional 180 days from the date of the forthcoming NASDAQ notice, to implement its plan, there can be no assurance that the Panel will grant XOMA's request for continued listing.

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### **Investor Conference Call**

XOMA will host a conference call and webcast to discuss its full-year and fourth quarter 2009 financial results today, March 11, 2009, at 4:30 pm ET. The webcast can be accessed via the Investors section of XOMA's website at <http://investors.xoma.com/events.cfm> and will be available for replay until close of business on June 11 2010. Telephone numbers for the live audiocast are 877-369-6589(U.S./Canada) and 408-337-0122(international). A telephonic replay will be available beginning approximately two hours after the conclusion of the call until close of business on March 18, 2010. Telephone numbers for the replay are 800-642-1687 (U.S./Canada) and 706-645-9291 (international), conference ID 61024144.

### **About XOMA**

XOMA discovers, develops and manufactures novel antibody therapeutics for its own proprietary pipeline as well as through license and collaborative agreements with pharmaceutical and biotechnology companies, and under its contracts with the U.S. government. The company's proprietary product pipeline includes:

- XOMA 052, an anti-IL-1 beta antibody in Phase 2 clinical development for Type 2 diabetes, Type 1 diabetes and cardiovascular disease, with potential for the treatment of a wide range of inflammatory conditions.
- XOMA 3AB, an antibody candidate in pre-IND studies to neutralize the botulinum toxin, among the most deadly potential bioterror threats, under development through funding provided by the National Institute of Allergy and Infectious Diseases of the National Institutes of Health (Contract # HHSN266200600008C).
- A preclinical pipeline with candidates in development for several diseases.

In addition to its proprietary pipeline, XOMA develops products with premier pharmaceutical companies including Novartis AG, Schering Corporation, a subsidiary of Merck & Co., Inc. and Takeda Pharmaceutical Company Limited.

XOMA's technologies have contributed to the success of marketed antibody products, including LUCENTIS(r) (ranibizumab injection) for wet age-related macular degeneration and CIMZIA(r) (certolizumab pegol) for rheumatoid arthritis and Crohn's disease.

The company has a premier antibody discovery and development platform that incorporates an unmatched collection of antibody phage display libraries and proprietary Human Engineering(tm), affinity maturation, Bacterial Cell Expression (BCE) and manufacturing technologies. BCE is a key breakthrough biotechnology for the discovery and manufacturing of antibodies and other proteins. As a result, more than 50 pharmaceutical and biotechnology companies have signed BCE licenses, and several licensed product candidates are in clinical development.

XOMA has a fully integrated product development infrastructure, extending from pre-clinical science to approval, and a team of about 200 employees at its Berkeley, California location. For more information, please visit <http://www.xoma.com>.

The XOMA Ltd. logo is available at <http://www.globenewswire.com/newsroom/prs/?pkgid=5960>

### **Safe Harbor Statement**

Certain statements contained herein concerning conduct or availability of results of clinical trials, entry into a XOMA 052 development partnership or potential licensing and collaboration arrangements or other aspects of product development, or that otherwise relate to future periods, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are based on assumptions that may not prove accurate. Actual results could differ materially from those anticipated due to certain risks inherent in the biotechnology industry and for companies engaged in the development of new products in a regulated market.

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Among other things, the conduct or availability of results of clinical trials may be impacted by, or delayed or may never occur as a result of, unavailability of resources, actions or inaction by our present or future collaboration partners, insufficient enrollment in such trials or unanticipated safety issues; and a XOMA 052 partnership may not be entered into in the timeframes indicated or at all.

These and other risks, including those related to in ability to comply with NASDAQ's continued listing requirements; the generally unstable nature of current economic conditions; the results of discovery research and preclinical testing; the timing or results of pending and future clinical trials (including the design and progress of clinical trials; safety and efficacy of the products being tested; action, inaction or delay by the FDA, European or other regulators or their advisory bodies; and analysis or interpretation by, or submission to, these entities or others of scientific data); uncertainties regarding the status of biotechnology patents; uncertainties as to the cost of protecting intellectual property; changes in the status of the existing collaborative and licensing relationships; the ability of collaborators, licensees and other third parties to meet their obligations; market demand for products; scale up and marketing capabilities; competition; international operations; share price volatility; XOMA's financing needs and opportunities; and risks associated with XOMA's status as a Bermuda company, are described in more detail in XOMA's most recent annual report on Form 10-K and in other SEC filings. Consider such risks carefully in considering XOMA's prospects.

SOURCE: XOMA Ltd.

Tables follow –

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**XOMA Ltd.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except per share amounts)

	Three months ended December 31,		Twelve months ended December 31,	
	2009	2008	2009	2008
<b>Revenues:</b>				
License and collaborative fees	\$ 14,546	\$ 14,900	\$ 43,822	\$ 16,366
Contract and other revenue	6,830	15,745	25,492	30,473
Royalties	221	6,275	29,116	21,148
Total revenues	<u>21,597</u>	<u>36,920</u>	<u>98,430</u>	<u>67,987</u>
<b>Operating expenses:</b>				
Research and development	14,659	20,132	58,131	82,576
Selling, general and administrative	4,764	5,161	23,736	24,145
Restructuring	—	—	3,603	—
Total operating expenses	<u>19,423</u>	<u>25,293</u>	<u>85,470</u>	<u>106,721</u>
Income (loss) from operations	2,174	11,627	12,960	(38,734)
<b>Other income (expense):</b>				
Investment and interest income	2	62	49	859
Interest expense	(110)	(2,042)	(4,888)	(7,002)
Loss on debt extinguishment	—	—	(3,645)	(652)
Other income (expense)	561	(48)	1,801	(99)
Net income (loss) before taxes	2,627	9,599	6,277	(45,628)
Provision for income tax expense (benefit)	(356)	(383)	5,727	(383)
Net income (loss)	<u>\$ 2,983</u>	<u>\$ 9,982</u>	<u>\$ 550</u>	<u>\$ (45,245)</u>
Basic and diluted net income (loss) per common share	<u>\$ 0.01</u>	<u>\$ 0.07</u>	<u>\$ —</u>	<u>\$ (0.34)</u>
Shares used in computing basic net income (loss) per common share	<u>199,708</u>	<u>134,906</u>	<u>164,900</u>	<u>132,928</u>
Shares used in computing diluted net income (loss) per common share	<u>204,679</u>	<u>138,727</u>	<u>169,720</u>	<u>132,928</u>

**XOMA Ltd.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands)

	December 31,	
	2009	2008
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$23,909	\$ 9,513
Short-term investments	—	1,299
Restricted cash	—	9,545
Trade and other receivables, net	7,231	16,686
Prepaid expenses and other current assets	1,012	1,296
Debt issuance costs	—	365
Total current assets	32,152	38,704
Property and equipment, net	20,270	26,843
Debt issuance costs – long-term	—	1,224
Other assets	402	402
Total assets	\$52,824	\$ 67,173
<b>LIABILITIES AND SHAREHOLDERS' EQUITY (NET CAPITAL DEFICIENCY)</b>		
Current liabilities:		
Accounts payable	\$ 2,942	\$ 9,977
Accrued liabilities	8,629	4,438
Accrued interest	10	1,588
Deferred revenue	2,114	9,105
Warrant liability	4,760	—
Other current liabilities	223	1,884
Total current liabilities	18,678	26,992
Deferred revenue – long-term	2,894	8,108
Interest bearing obligations – long-term	13,341	63,274
Other long-term liabilities	385	200
Total liabilities	35,298	98,574
Shareholders' equity (net capital deficiency)	17,526	(31,401)
Total liabilities and shareholders' equity (net capital deficiency)	\$52,824	\$ 67,173