

PHOTON DYNAMICS, INC.

CHARTER OF THE COMPENSATION AND EMPLOYEE OWNERSHIP COMMITTEE

The Charter of the Compensation and Employee Ownership Committee (the “Committee”) of Photon Dynamics, Inc., a California corporation, (the “Company”) is as follows:

COMPOSITION

The Committee shall consist of at least three (3) members of the Board of Directors, none of whom shall be employees of the Company and each of whom shall be free from any relationship that would interfere with the exercise of his or her independent judgment, as determined by the Board of Directors and in accordance with the independence requirements of The Nasdaq Stock Market (“Nasdaq”); *provided, however*, that if permitted by the Nasdaq rules, one (1) member need not meet the independence requirements under the conditions specified by such requirements. The members of the Committee shall also satisfy the “outside director” standard within the meaning of Section 162(m) of the Internal Revenue Code, as amended (or any successor to Section 162(m) as in effect from time to time), and income tax regulations promulgated thereunder as in effect from time to time, and the “non-employee director” standard within the meaning of Rule 16b-3 promulgated under the Securities Exchange Act of 1934 (or any successor to Rule 16b-3 as in effect from time to time).

AUTHORITY

The Committee shall have full access to all books, records, facilities and personnel of the Company as deemed necessary or appropriate by any member of the Committee to discharge his or her responsibilities hereunder. The Committee shall have the authority to obtain, at the expense of the Company, advice and assistance from internal or external legal, accounting or other advisors and consultants. In addition, the Committee shall have sole authority to retain and terminate any compensation consultant to assist in the evaluation of director, chief executive officer or senior executive compensation, including sole authority to approve such consultant’s reasonable fees and other retention terms, all at the Company’s expense. Other reasonable expenditures for external resources that the Committee deems necessary or appropriate in the performance of its duties are permitted. Expenditures for external resources (other than for a compensation consultant retained by the Committee) that are expected to be material and outside the ordinary course of the Committee’s practices shall be recommended by the Committee for the approval of the Board of Directors. The Committee may form and delegate authority to subcommittees as appropriate, including, but not limited to, a subcommittee composed of at least two members of the Board to grant stock awards under the Company’s Plans to persons who are not: (a) “Covered Employees” under Section 162(m) of the Code; (b) individuals with respect to whom the Company wishes to comply with Section 162(m) of the Code; or (c) then subject to Section 16 of the Exchange Act. The approval of this Charter shall be construed as a delegation of authority to the Committee with respect to the responsibilities set forth herein.

RESPONSIBILITIES

The Committee shall have the full power and authority to carry out the following responsibilities:

1. To take any and all actions which may be taken by the Board of Directors of the Company with respect to fixing the compensation level of the Company's chief executive officer after evaluating the chief executive officer's performance in light of relevant corporate performance goals and objectives. The chief executive officer may not be present during these deliberations and may not be present during voting.

2. To take any and all actions which may be taken by the Board of Directors of the Company with respect to fixing the compensation level of all other executive officers of the Company, including but not limited to the development of compensation policies that will attract and retain the highest quality executives, that will clearly articulate the relationship of corporate performance to executive compensation and that will reward executives for the Company's progress, and the budget for the compensation of other employees of the Company. The chief executive officer may be present during these deliberations, but may not vote.

3. To propose the adoption, amendment, and termination of stock option plans, stock appreciation rights plans, pension and profit sharing plans, stock bonus plans, stock purchase plans, bonus plans, deferred compensation plans, and other similar programs ("Compensation Plans").

4. To grant rights, participation and interests in Compensation Plans to eligible participants.

5. To review and approve such other compensation matters as the Board of Directors or the Chief Executive Officer of the Company wishes to have the Committee approve.

6. To review the report required to be filed with the Company's proxy or information statement that shall disclose the compensation policies applicable to the Company's executive officers.

7. To perform such other functions and have such other powers as may be necessary or convenient in the efficient discharge of the foregoing.

8. To report to the Board of Directors from time to time, or whenever it shall be called upon to do so.

MEETINGS

The Committee will hold at least one (1) regular meeting per year and additional meetings as the Committee deems appropriate. Subject to the limitations set forth above, officers of the Company may attend these meetings at the invitation of the Committee.

MINUTES AND REPORTS

Minutes of each meeting of the Committee shall be kept and distributed to each member of the Committee and the Secretary of the Company. The Chairperson of the Committee shall report to the Board of Directors from time to time, or whenever so requested by the Board.