

Photon Dynamics, Inc.
Corporate Governance Guidelines
Adopted December 15, 2006

The Board of Directors, as representatives of the stockholders, is committed to the achievement of business success and the enhancement of long-term stockholder value with the highest standards of integrity and ethics. In that regard, the Board has adopted these principles to provide an effective corporate governance framework for Photon's governance and management systems and its interactions with others.

1. Composition of the Board and Board Membership Criteria

The Nominating and Corporate Governance Committee shall establish membership criteria for the Board of Directors of the Company, which shall include the criteria, set forth in these Corporate Governance Guidelines, and shall recommend individuals to the Board to fill any director positions. In making its recommendations, the Nominating and Corporate Governance Committee shall:

- review candidates' qualifications for Board membership (including a determination as to the independence of the candidate) based on the criteria established by the Nominating and Corporate Governance Committee;
- in evaluating current directors for re-nomination to the Board, assess the performance of such director; and
- review from time to time the composition of the Board in light of the current needs of the Board and the Company, and determine whether changes in Board composition may be appropriate.

The Nominating and Corporate Governance Committee will consider director candidates recommended by shareholders. The Nominating and Corporate Governance Committee does not intend to alter the manner in which it evaluates candidates based on whether the candidate was recommended by a shareholder or not. Shareholders who wish to recommend individuals for consideration by the Nominating and Corporate Governance Committee to become nominees for election to the Board may do so by delivering a written recommendation to the Nominating and Corporate Governance Committee at the following address: 5970 Optical Court, San Jose, California, 95138-1400 not less than six months prior to any meeting at which directors are to be elected. Submissions must include the full name of the proposed nominee, a description of the proposed nominee's business experience for at least the previous five years, complete biographical information, a description of the proposed nominee's qualifications as a director and a representation that the nominating shareholder is a beneficial or record owner of Photon Dynamics' stock. Any such submission must be accompanied by the written consent of the proposed nominee to be named as a nominee and to serve as a director if elected. To date, the Nominating and Corporate Governance Committee has not received a timely director nominee from a shareholder of Photon Dynamics.

2. Director Qualifications

Term Limits

The Board believes that director term limits would not maximize the effectiveness of the Board. The Board believes that term limits could result in the loss of the contributions of directors who have developed experience and insights.

As an alternative to term limits, the Nominating and Corporate Governance Committee will periodically review the appropriateness of each director's continued service.

Retirement Age

A director may not stand for reelection after reaching the age of 72, but need not resign until the end of his or her term. Exceptions to this policy require the approval of the Nominating and Corporate Governance Committee.

Service on Other Boards

Every director must notify the Board prior to accepting any invitations to serve on another corporate board or advisory board or with a government commission or similar body. The Nominating and Corporate Governance Committee shall evaluate the continued appropriateness of Board membership and make a recommendation to the Board. An independent director of the Company may not sit on more than four boards of public, for-profit companies, including the Company's Board. A director who is an executive of the Company may not sit on more than three public, for-profit companies, including the Company's Board.

Changes in Primary Employment

Every director must notify the Board or the Nominating and Corporate Governance Committee of his or her retirement, and change in employer and any other significant change in professional roles and responsibilities. The Nominating and Corporate Governance Committee shall evaluate the continued appropriateness of the Board membership under the new circumstances and make a recommendation to the Board as to any action to be taken with respect to continued Board membership.

Conflicts of Interest

If an actual or potential conflict of interest develops because of a change in the business of the Company, or in a director's circumstances (for example, significant competition between the Company and a business with which the director is affiliated), the director should report the matter immediately to the full Board for evaluation and appropriate resolution.

If a director has a personal interest in a matter before the Board, the director shall disclose the interest to the full Board, recuse himself or herself from participation in the related discussion and abstain from voting on the matter.

Each director is required to disclose annually in writing to the Nominating and Corporate Governance Committee all of his or her board of director, advisory board or equivalent positions in other companies (private or public, including non-profit entities).

Stock Ownership

Non-employee directors should hold shares, restricted share units or vested stock options of the Company's stock with a value equal to at least three times his or her annual base retainer which shall not include any amounts in excess of base retainer for serving as board or committee chair. The stock ownership target should be met within the later of (i) five years after a non-employee director's election to the Board; or (ii) five years after the original date of adoption of these Corporate Governance Guidelines. Directors who have not reached the stock ownership target shall not sell or otherwise transfer share of company stock until the target is met. Value is defined as the spread value which is the difference between the exercise price, if any, and the closing price of the Company shares on the NASDAQ exchange at the annual measurement date

multiplied by the number of shares, options or restricted share units. The annual measurement date is a date which occurs on the tenth business day following the Annual Meeting date.

3. Director Responsibilities

The Board acts as the ultimate decision-making body of the Company and advises and oversees management, who are responsible for the day-to-day management of the Company. The Company's directors should exercise their business judgment in order to act in a manner they reasonably believe is in the best interests of the Company and its stockholders and in a manner consistent with their fiduciary duties.

In order for the Board to exercise fully its oversight functions, management provides the Board with access to information from a variety of sources, including management reports, security analysts' reports, information regarding peer performance, information concerning customer relationships, and interaction with senior management at Board meetings. Any materials that would assist directors in preparing for a Board committee meeting shall be distributed or made available in advance of the meeting to the extent possible.

4. Frequency of Board Meetings and Board Agenda

It is the policy of the Board to have at least four scheduled meetings, per year, and to meet more frequently if circumstances warrant. The Chairman of the Board shall schedule and determine the length of Board meetings and shall set the agenda for each Board meeting. Board members are encouraged to suggest the inclusion of additional agenda items, and any director may request that an item be placed on the agenda.

A portion of each regular Board meeting will be devoted to an executive session in which the Chairman of the Board, the Chief Executive Officer and independent directors may discuss the condition of the Company's management, who are not directors, being present.

A portion of each regular Board meeting will also be devoted to a private session for the independent directors.

5. Board Size

The maximum size of the Board is set forth in the Bylaws. Although the Board considers its present size to be appropriate, it may consider expanding its size to accommodate an outstanding candidate and to provide new viewpoints and areas of expertise. The Nominating and Corporate Governance Committee shall review the size of the Board from time to time and recommend changes.

6. Board Committee

The Board shall have at all times an Audit Committee, Compensation and Employee Ownership Committee, and a Nominating and Corporate Governance Committee, each of which shall operate pursuant to its own written charter. Committee charters shall, among other things, set forth the purpose, goals and responsibilities of the committee, procedures for member appointment and removal, and committee structure and operations, as well as requirements for reporting to the Board. All members of the Audit Committee, Compensation and Employee Ownership Committee and Nominating and Corporate Governance Committee shall be independent to the extent required by SEC or stock exchange rules. The Nominating and Corporate Governance Committee shall establish membership criteria for each committee and shall recommend directors for appointment, including the Chairman. The Board may create additional committees as it deems appropriate.

In making recommendations for committee appointments, the Nominating and Corporate Governance Committee shall:

- review candidates' qualifications (including a determination as to the independence of the candidate) based on the criteria established by the Nominating and Corporate Governance Committee;
- in evaluating current directors for reappointment to a committee of the Board, assess the performance of such director; and
- from time to time review the composition of each committee in light of current requirements, and determine whether changes would be appropriate.

The Board's policy is not to require fixed rotation of committee assignments because the Board believes there are benefits attributable to continuity and experience.

The Nomination and Corporate Governance Committee will periodically lead the Board in a self-evaluation. The Board will discuss the evaluation with a view to improving Board and committee performance.

The Nomination and Corporate Governance Committee, together with the Board, shall also periodically review the Corporate Governance Guidelines to determine whether changes would be appropriate.

7. Board Member Access to Management and Independent Advisors

The Board and each committee has the authority to retain independent legal, financial, accounting or other advisors as it determines necessary to carry out its duties, without conferring with or obtaining the approval of management or, in the case of a committee, the full Board. The Board shall have access to any officer or employee of the Company or the Company's outside counsel, independent auditors or external parties, and may request that any such parties meet with any members of, or advisers to, the Board, and the Board may otherwise seek information from any of the foregoing. Any meetings or contacts that a director wishes to initiate may be arranged through the Chief Executive Officer of the Secretary or directly by the Board.

Executive officers and other members of senior management are expected to be present at board meetings at the invitation of the Board. The Board encourages senior management to make presentations and to invite to the Board meetings, managers and other employees who can provide additional insight into the items being discussed. The Board also encourages senior management to include in board meetings individuals that the senior management believes may become prospective leaders of the Company.

The Company's independent auditors will report directly to the Audit Committee.

8. Director Compensation

The Nominating and Corporate Governance Committee shall review and approve compensation (including equity-based compensation) for the Company's directors. In reviewing and approving director compensation, the Nominating and Corporate Governance Committee shall identify corporate objectives relevant to director compensation with a view to creating appropriate alignment with those objectives.

Notwithstanding the foregoing, director compensation may instead be approved by the Board to the extent the Nominating and Corporate Governance Committee deems advisable to comply with SEC or stock exchange requirements.

Proposed charitable contributions or pledges of charitable contribution, by the Company within any fiscal year in an aggregate amount of \$10,000 or more, to an entity for which a director

or a member of his or her immediate family serves as a director, officer, employee or member of such entity's fund-raising organization or committee, shall be subject to prior review and approval by the Nominating and Corporate Governance Committee.

The Nominating and Corporate Governance Committee shall be provided on an annual basis with a report from management of the charitable contributions or pledges made by the Company during the fiscal year in an amount of \$10,000 or more, to an entity for which a director or executive officer, or a member of his or her immediate family, serves as a director, officer, employee or member of such entity's fund-raising organization or committee.

9. Director Orientation and Continuing Education

The Board or the Company will establish or provide access to appropriate orientation programs, sessions or materials for newly elected directors for their benefit either prior to or within a reasonable period of time after their nomination or election as a director. This orientation may include presentations by senior management to familiarize new directors with the Company's strategic plans, its significant financial, accounting and risk management issues, its Code of Ethics and Business Conduct, its principal officers, and its independent auditors.

10. Management Evaluation, Succession and Compensation

The Compensation Committee shall evaluate the performance of the senior management of the Company and shall present its findings to the full Board. The Board shall review the Compensation Committee's report in order to ensure that management's performance is satisfactory and that management is providing the best leadership for the Company in the long- and short-term.

The Compensation Committee shall, in consultation with the Company's Chief Executive Officer, review and report to the Board the Company's management succession planning, including succession planning in the event of the incapacitation, retirement or removal of the Chief Executive Officer, and recommendations and evaluations of potential successors, along with a review of any development plans recommended for such individuals. The Chief Executive Officer shall provide to the Board, on an ongoing basis, his or her recommendation as to a successor in the event of an unexpected emergency.

The Compensation Committee shall review and approve for each of the Company's executives which report directly to the CEO or such other executives as the Committee shall request from time to time, his or her (i) annual base salary level, (ii) annual incentive compensation, if any, (iii) long-term incentive compensation, (iv) employment, severance and change-in-control agreements, if any, and (v) any other compensation, ongoing perquisites or special benefit items; *provided* that to the extent required by SEC or stock exchange requirements, stock option grants, restricted stock grants and other equity-based compensation of the Company's executives shall be recommended by the Compensation Committee and shall be approved by the Board.

11. Process for Stockholder Communications with the Board

Shareholders who wish to communicate with the Board or an individual director may send a written communication addressed to Photon Dynamics, 5970 Optical Court, San Jose, California, 95138-1400, and attention: Corporate Secretary. Communications may also be sent by e-mail to the following address: board@photodynamics.com. Each communication sent must state the number of shares owned by the shareholder making the communication.

12. Stockholder Ratification of Independent Auditors

Although the Board acknowledges that current law, rules and regulations, as well as the Charter of the Board's Audit Committee, require Photon's independent auditors to be engaged, retained and supervised by the Audit Committee, the Board considers the selection of independent auditors to be an important matter of stockholder concern and considers a proposal for stockholders to ratify such selection to be an important opportunity for stockholders to provide direct feedback to the Board on an important issue of corporate governance. Consequently, the Board will present such a proposal to the stockholders in the proxy statement related to each annual meeting of stockholders recommendation to the Board by majority vote.