

HOLLIS EDEN PHARMACEUTICALS INC /DE/  
Form DEF 14A  
April 27, 2006

## SCHEDULE 14A INFORMATION

### Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934

Filed by the Registrant

Filed by a Party other than the Registrant   
Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to § 240.14a-11(c) or § 240.14a-12

## Hollis-Eden Pharmaceuticals, Inc.

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(Name of Registrant as Specified In Its Charter)

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(Name of Person(s) Filing Proxy Statement if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box)

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

1. Title of each class of securities to which transaction applies:

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2. Aggregate number of securities to which transaction applies:

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3. Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined):

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6. Amount Previously Paid:

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7. Form, Schedule or Registration Statement No.:

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8. Filing Party:

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9. Date Filed:

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**HOLLIS-EDEN PHARMACEUTICALS, INC.**

**4435 Eastgate Mall, Suite 400**

**San Diego, CA 92121**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

**TO BE HELD ON JUNE 9, 2006**

TO THE STOCKHOLDERS OF HOLLIS-EDEN PHARMACEUTICALS, INC.:

**NOTICE IS HEREBY GIVEN** that the Annual Meeting of Stockholders of **HOLLIS-EDEN PHARMACEUTICALS, INC.**, a Delaware corporation (the Company), will be held on Friday, June 9, 2006 at 2:00 p.m. local time at the La Jolla Hilton, 10950 North Torrey Pines Road, La Jolla, California 92037, for the following purposes:

1. To elect two Class III directors to hold office until the 2009 Annual Meeting of Stockholders.
2. To amend the Company's 2005 Equity Incentive Plan, as amended, to increase the aggregate number of shares of common stock authorized for issuance under such Plan by 500,000 shares.
3. To amend the Company's 2005 Non-Employee Directors' Equity Incentive Plan, as amended, to increase the aggregate number of shares of common stock authorized for issuance under such Plan by 150,000 shares.
4. To ratify the selection by the audit committee of the board of directors of BDO Seidman, LLP as the independent registered public accounting firm of the Company for its fiscal year ending December 31, 2006.
5. To transact such other business as may properly come before the meeting or any adjournment or postponement thereof.

The foregoing items of business are more fully described in the Proxy Statement accompanying this Notice.

The board of directors has fixed the close of business on April 13, 2006, as the record date for the determination of stockholders entitled to notice of and to vote at this annual meeting and at any adjournment or postponement thereof.

By Order of the Board of Directors  
RICHARD B. HOLLIS  
Chairman of the Board, President and  
Chief Executive Officer

San Diego, California

April 27, 2006

**ALL STOCKHOLDERS ARE CORDIALLY INVITED TO ATTEND THE ANNUAL MEETING IN PERSON. WHETHER OR NOT YOU EXPECT TO ATTEND THE ANNUAL MEETING, PLEASE COMPLETE, DATE, SIGN AND RETURN THE ENCLOSED PROXY AS PROMPTLY AS POSSIBLE IN ORDER TO ENSURE YOUR REPRESENTATION AT THE ANNUAL MEETING. A RETURN ENVELOPE (WHICH IS POSTAGE PREPAID IF MAILED IN THE UNITED STATES) IS ENCLOSED FOR THAT PURPOSE. EVEN IF YOU HAVE GIVEN YOUR PROXY, YOU MAY STILL VOTE IN PERSON IF YOU ATTEND THE ANNUAL MEETING. PLEASE NOTE, HOWEVER, THAT IF YOUR SHARES ARE HELD OF RECORD BY A BROKER, BANK OR OTHER NOMINEE AND YOU WISH TO VOTE AT THE ANNUAL MEETING, YOU MUST OBTAIN FROM THE RECORD HOLDER A**

**PROXY ISSUED IN YOUR NAME.**

**HOLLIS-EDEN PHARMACEUTICALS, INC.**

**4435 Eastgate Mall, Suite 400**

**San Diego, CA 92121**

**PROXY STATEMENT**

**FOR THE 2006 ANNUAL MEETING OF STOCKHOLDERS**

**June 9, 2006**

**QUESTIONS AND ANSWERS ABOUT THIS PROXY MATERIAL AND VOTING**

**Why am I receiving these materials?**

We sent you this proxy statement and the enclosed proxy card because the board of directors of Hollis-Eden Pharmaceuticals, Inc. (sometimes referred to in this proxy statement as we, us, the Company or Hollis-Eden) is soliciting your proxy to vote at the 2006 annual meeting of stockholders. You are invited to attend the annual meeting to vote on the proposals described in this proxy statement. However, you do not need to attend the annual meeting to vote your shares. Instead, you may simply complete, sign and return the enclosed proxy card.

We intend to begin mailing this proxy statement and accompanying proxy card on or about May 8, 2006 to all stockholders of record entitled to vote at the annual meeting.

**Who can vote at the annual meeting?**

Only stockholders of record at the close of business on April 13, 2006 will be entitled to vote at the annual meeting. On this record date, there were 24,836,535 shares of our common stock outstanding and entitled to vote.

*Stockholder of Record: Shares Registered in Your Name*

If on April 13, 2006 your shares were registered directly in your name with our transfer agent, American Stock Transfer & Trust Company, then you are a stockholder of record. As a stockholder of record, you may vote in person at the annual meeting or vote by proxy. Whether or not you plan to attend the annual meeting, we urge you to fill out and return the enclosed proxy card to ensure your vote is counted.

*Beneficial Owner: Shares Registered in the Name of a Broker or Bank*

If on April 13, 2006 your shares were held in an account at a brokerage firm, bank, dealer, or other similar organization, then you are the beneficial owner of shares held in street name and these proxy materials are being forwarded to you by that organization. The organization holding your account is considered the stockholder of record for purposes of voting at the annual meeting. As a beneficial owner, you have the right to direct your broker or other agent on how to vote the shares in your account. You are also invited to attend the annual meeting. However, since you are not the stockholder of record, you may not vote your shares in person at the meeting unless you request and obtain a valid proxy from your broker or other agent.

**What am I voting on?**

There are four matters scheduled for a vote:

Election of two Class III directors to hold office until the 2009 annual meeting of stockholders;

Proposed amendment to our 2005 Equity Incentive Plan, as amended, to increase the aggregate number of shares of common stock authorized for issuance under such Plan by 500,000 shares;



Proposed amendment to our 2005 Non-Employee Directors Equity Incentive Plan, as amended, to increase the aggregate number of shares of common stock authorized for issuance under such Plan by 150,000 shares; and

Ratification of BDO Seidman, LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2006.

**How do I vote?**

You may either vote For all the nominees to our board of directors or you may withhold your vote for any nominee you specify. For each of the other matters to be voted on, you may vote For or Against or abstain from voting. The procedures for voting are fairly simple:

*Stockholder of Record: Shares Registered in Your Name*

If you are a stockholder of record, you may vote in person at the annual meeting or vote by proxy using the enclosed proxy card. Whether or not you plan to attend the annual meeting, we urge you to vote by proxy to ensure your vote is counted. You may still attend the annual meeting and vote in person if you have already voted by proxy.

To vote in person, come to the annual meeting and we will offer you a ballot when you arrive.

To vote using the proxy card, simply complete, sign and date the enclosed proxy card and return it promptly in the envelope provided.

If you return your signed proxy card to us before the annual meeting, we will vote your shares as you direct.

*Beneficial Owner: Shares Registered in the Name of Broker or Bank*

If you are a beneficial owner of shares registered in the name of your broker, bank, or other agent, you should have received a proxy card and voting instructions with these proxy materials from that organization rather than from us. Simply complete and mail the proxy card to ensure that your vote is counted. To vote in person at the annual meeting, you must obtain a valid proxy from your broker, bank, or other agent. Follow the instructions from your broker or bank included with these proxy materials, or contact your broker or bank to request a proxy form.

**How many votes do I have?**

On each matter to be voted upon, you have one vote for each share of common stock you own as of April 13, 2006, the record date for the determination of stockholders entitled to notice of and to vote at the annual meeting and at any adjournment or postponement thereof.

**What if I return a proxy card but do not make specific choices?**

If you return a signed and dated proxy card without marking any voting selections, your shares will be voted For the election of all nominees for director, For the approval of the proposed amendment to our 2005 Equity Incentive Plan, as amended, to increase the aggregate number of shares of common stock authorized for issuance under such Plan by 500,000 shares, For the approval of the proposed amendment to our 2005 Non-Employee Directors Equity Incentive Plan, as amended, to increase the aggregate number of shares of common stock authorized for issuance under such Plan by 150,000 shares and For the ratification of the selection of BDO Seidman, LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2006. If any other matter is properly presented at the annual meeting, your proxy (one of the individuals named on your proxy card) will vote your shares using his best judgment.

**Who is paying for this proxy solicitation?**

We will pay for the entire cost of soliciting proxies. In addition to these mailed proxy materials, our directors and employees may also solicit proxies in person, by telephone, or by other means of communication. Directors and employees will not be paid any additional compensation for soliciting proxies. We may also reimburse brokerage firms, banks and other agents for the cost of forwarding proxy materials to beneficial owners.

**What does it mean if I receive more than one proxy card?**

If you receive more than one proxy card, your shares are registered in more than one name or are registered in different accounts. Please complete, sign and return each proxy card to ensure that all of your shares are voted.

**Can I change my vote after submitting my proxy?**

Yes. You can revoke your proxy at any time before the final vote at the annual meeting. You may revoke your proxy in any one of three ways:

You may submit another properly completed proxy card with a later date.

You may send a written notice that you are revoking your proxy to our Secretary at 4435 Eastgate Mall, Suite 400, San Diego, California 92121.

You may attend the annual meeting and vote in person. Simply attending the annual meeting will not, by itself, revoke your proxy.

**When are stockholder proposals due for next year's annual meeting?**

To be considered for inclusion in next year's proxy materials, your proposal must be submitted in writing by January 10, 2007, to our Secretary at 4435 Eastgate Mall, Suite 400, San Diego, California 92121. If you wish to submit a proposal that is not to be included in next year's proxy materials, your proposal generally must be submitted in writing to the same address no later than March 11, 2007 but no earlier than February 9, 2007.

**How are votes counted?**

Votes will be counted by the inspector of election appointed for the annual meeting, who will separately count For and (with respect to proposals other than the election of directors because directors are elected by a plurality of votes cast at the annual meeting) Against votes, abstentions and broker non-votes. A broker non-vote occurs when a nominee holding shares for a beneficial owner does not vote on a particular proposal because the nominee does not have discretionary voting power with respect to that proposal and has not received instructions with respect to that proposal from the beneficial owner. Abstentions will be counted towards the vote total for each proposal, and will have the same effect as Against votes. Broker non-votes have no effect and will not be counted towards the vote total for any proposal.

If on April 13, 2006 your shares were held in an account at a brokerage firm, bank, dealer, or other similar organization, then you are the beneficial owner of shares held in street name and these proxy materials are being forwarded to you by that organization. The organization holding your account is considered the stockholder of record for purposes of voting at the annual meeting. As a beneficial owner, you have the right to direct your broker or other agent on how to vote the shares in your account. You are also invited to attend the annual meeting. However, since you are not the stockholder of record, you may not vote your shares in person at the meeting unless you request and obtain a valid proxy from your broker or other agent.

**How many votes are needed to approve each proposal?**

For the election of directors, the two nominees receiving the most For votes (among votes properly cast in person or by proxy) will be elected. Abstentions and broker non-votes will have no effect.





To be approved, Proposal No. 2, the proposed amendment to our 2005 Equity Incentive Plan, as amended, to increase the aggregate number of shares of common stock authorized for issuance under such Plan by 500,000 shares, must receive a For vote from the majority of shares present and entitled to vote either in person or by proxy. If you Abstain from voting, it will have the same effect as an Against vote. Broker non-votes will have no effect.

To be approved, Proposal No. 3, the proposed amendment to our 2005 Non-Employee Directors Equity Incentive Plan, as amended, to increase the aggregate number of shares of common stock authorized for issuance under such Plan by 150,000 shares, must receive a For vote from the majority of shares present and entitled to vote either in person or by proxy. If you Abstain from voting, it will have the same effect as an Against vote. Broker non-votes will have no effect.

To be approved, Proposal No. 4, the ratification of the selection of BDO Seidman, LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2006, must receive a For vote from the majority of shares present and entitled to vote either in person or by proxy. If you Abstain from voting, it will have the same effect as an Against vote. Broker non-votes will have no effect.

**What is the quorum requirement?**

A quorum of stockholders is necessary to hold a valid annual meeting. A quorum will be present if at least a majority of the outstanding shares are represented by stockholders present at the annual meeting or by proxy. On the record date of April 13, 2006, there were 24,836,535 shares outstanding and entitled to vote.

Your shares will be counted towards the quorum only if you submit a valid proxy vote or vote at the meeting. Abstentions and broker non-votes will be counted towards the quorum requirement. If there is no quorum, a majority of the votes present or represented by proxy at the meeting may adjourn the meeting to another date.

**How can I find out the results of the voting at the annual meeting?**

Preliminary voting results will be announced at the annual meeting. Final voting results will be published in our quarterly report on Form 10-Q for the second quarter of 2006.

**Proposal 1**

**ELECTION OF DIRECTORS**

Our restated certificate of incorporation and bylaws provide that our board of directors shall be divided into three classes, each class consisting, as nearly as possible, of one-third of the total number of directors, with each class having a three-year term. Vacancies on our board may be filled only by persons elected by a majority of the remaining directors. A director elected by our board to fill a vacancy (including a vacancy created by an increase in the size of our board of directors) shall serve for the remainder of the full term of the class of directors in which the vacancy occurred and until such director's successor is elected and qualified. It is our policy to invite nominees for directors to attend the annual meeting. All of our directors attended last year's annual meeting.

Our board of directors is presently composed of seven members. There are two directors in the class whose term of office expires in 2006. The nominees for election to this class, Richard B. Hollis and Salvatore J. Zizza, are current members of our board of directors, having been elected by the stockholders. If elected at the annual meeting, each of the nominees would serve until the 2009 annual meeting and until his successor is elected and has qualified, or until his earlier death, resignation or removal.

Directors are elected by a plurality of the votes present in person or represented by proxy and entitled to vote at the meeting. Proxies cannot be voted for a greater number of persons than the number of nominees

named. In the event that any nominee should be unavailable for election as a result of an unexpected occurrence, such shares will be voted for the election of a substitute nominee as our board of directors may propose upon recommendation from our nominating and corporate governance committee.

Set forth below is biographical information for each person nominated and each person whose term of office as a director will continue after the annual meeting.

**NOMINEES FOR ELECTION FOR A THREE-YEAR TERM EXPIRING AT THE 2009 ANNUAL MEETING**

*Richard B. Hollis*

Mr. Hollis, age 53, founded Hollis-Eden in August 1994, and currently serves as our Chairman, President and Chief Executive Officer. Mr. Hollis has over 25 years experience in the health care industry, has a proven track record of launching and marketing important new medical products, and a distinguished career of managing the growth and operations of companies in a variety of senior management positions. Mr. Hollis began his career in product sales with Baxter Travenol (today Baxter International), where he specialized in launching and marketing parenteral, enteral and intravenous solutions to hospitals and nursing homes. Mr. Hollis next joined Imed Corporation, a world leader in drug delivery devices in the 1980s, where he rapidly advanced through numerous sales, marketing and managerial positions. When Imed was acquired by Warner Lambert (today part of Pfizer Inc.), Mr. Hollis was one of two Division Managers at Imed. After leaving Warner Lambert, Mr. Hollis joined Genentech, Inc. as Western Business Unit Manager as the Bay Area biotechnology revolution was unfolding. At Genentech, Mr. Hollis was instrumental in the launch of two blockbuster pharmaceutical products Protropin (human growth hormone) and Activase (tissue plasminogen activator). Following those successful product launches, Mr. Hollis joined Instromedix, a manufacturer of cardiac monitoring devices, as General Manager and Vice President of Marketing and Sales, and subsequently was named Chief Operating Officer of Bioject Medical, a manufacturer of needleless drug delivery devices. In 1994 he acted on his vision of founding a new pharmaceutical company, Hollis-Eden, which he initially self-funded and successfully brought public in 1997. Mr. Hollis received his B.A. in Psychology from San Francisco State University after studying the humanities while attending St. Mary's College.

*Salvatore J. Zizza*

Mr. Zizza, age 60, has served as a member of our board of directors since March 1997. Mr. Zizza was elected as Lead Independent Director of our board of directors in March 2006. He served as Chairman of our board, President and Treasurer of Initial Acquisition Corp., from 1992 until March 1997, at which time Initial Acquisition Corp. merged with the Company. Mr. Zizza is presently Chairman of Hallmark Electrical Supplies Corp. Mr. Zizza is also Chairman of Bethlehem Advanced Materials. Mr. Zizza was President and Chief Financial Officer of NICO Construction Company, Inc. until 1985, when NICO merged with The LVI Group, Inc. Prior to joining The LVI Group, Inc., Mr. Zizza was an independent financial consultant and had been a lending officer for Chemical Bank. Mr. Zizza's current and former directorships include: The Gabelli Equity Trust (NYSE), The Gabelli Asset Fund, The Gabelli Growth Fund, The Gabelli Convertible and Income Securities Fund, The Gabelli Utility Trust Fund (NYSE), The Gabelli Global Multimedia Trust (NYSE), The Gabelli Equity Series Fund, The Gabelli Dividend and Income Trust, The Gabelli Gold Fund, the Gabelli International Growth Fund, The Gabelli Global Services, the Ned Davis Asset Allocation Fund, Westwood Funds, Earl Scheib Inc (ASE) and St. David's School. Mr. Zizza received a B.S. in Political Science and an M.B.A. from St. John's University.

**OUR BOARD OF DIRECTORS RECOMMENDS**

**A VOTE IN FAVOR OF EACH NAMED NOMINEE**

**DIRECTORS CONTINUING IN OFFICE UNTIL THE 2007 ANNUAL MEETING**

*Paul Bagley*

Mr. Bagley, age 63, has served as a member of our board of directors since March 1996. Mr. Bagley is a founding principal of Stone Pine Capital L.L.C., a group that provides mezzanine capital to fund acquisitions, buyouts, growth and recapitalizations, and is also associated with Stone Pine Advisors L.L.C., and Stone Pine Investment Banking L.L.C. Mr. Bagley was Chief Executive Officer of Laidlaw Holdings, Inc., an investment services company from January 1995 until November 1996. For more than twenty years, Mr. Bagley was engaged in investment banking activities with Shearson Lehman Hutton Inc. and its predecessor, E.F. Hutton & Company Inc. Mr. Bagley served in various capacities with Shearson and E.F. Hutton, including Executive Vice President and Director, Managing Director, Head of Direct Investment Origination and Manager of Corporate Finance. Mr. Bagley also serves as Chairman of the Board of Directors of Fortune Management Inc., a company listed on the Frankfurt Stock Exchange that provides services in the areas of asset management and private equity management, and Chairman of the Board of Directors of Angus Technologies, Inc., a privately held telecommunications and technology company. Mr. Bagley is also a director of VPSA Management S.A. and Hamilton Lane Private Equity Partners, L.L.C., an Irish Stock Exchange listed investment partnership. Mr. Bagley graduated from the University of California at Berkeley with a B.Sc. in Business and Economics and from Harvard Business School with an M.B.A. in Finance.

*Jerome M. Hauer*

Mr. Hauer, age 54, has served as a member of our board of directors since June 2004. Mr. Hauer is recognized as one of the nation's leading experts on bioterrorism and emergency preparedness, with over 20 years of experience in emergency management. Mr. Hauer currently serves as Chief Executive Officer of The Hauer Group LLC, a consulting firm. Previously, Mr. Hauer served as Senior Vice President, Fleishman-Hillard Government Relations from January 2005 to March 2006. He previously served as Executive Director of the Response to Emergencies and Disasters Institute (READI) and Associate Professor, School of Public Health at The George Washington University from November 2003 to October 2004. During the events of September 11, 2001 and the nation's anthrax crisis that followed, Mr. Hauer served as Senior Advisor to the Secretary of Health and Human Services (HHS) for National Security and Emergency Management from June 2001 to November 2003. In June 2002, HHS Secretary Tommy G. Thompson named Mr. Hauer as Acting Assistant Secretary for the Office of Public Health Emergency Preparedness. In this role, Mr. Hauer was responsible for coordinating the country's medical and public health preparedness and response to emergencies, including acts of biological, chemical and nuclear terrorism. Prior to serving at HHS, Mr. Hauer worked with Mayor Rudolph W. Giuliani as the first Director of the Mayor's Office of Emergency Management for New York City, charged with coordinating the city's emergency response plans from February 1996 to March 2000. Mr. Hauer is a member of the Johns Hopkins School of Public Health's Health Advisory Board and has served on the National Academy of Sciences Institute of Medicine's *Committee to Evaluate R&D Needs for Improved Civilian Medical Response to Chemical or Biological Terrorism Incidents*. Mr. Hauer is the recipient of numerous honors, including the Outstanding Alumni of the Year from the Johns Hopkins School of Public Health, the Indiana Commendation Medal for Exceptional Meritorious Service, the Legion of Hoosier Heroes Award and the Distinguished Alumni Award from NYU. He also is a member of the New York City Police Department's Honor Legion, and is an honorary Assistant Chief in the New York City Fire Department. Mr. Hauer graduated from New York University with a B.A. degree in psychology and history and from the Johns Hopkins School of Public Health with a Master's degree.

*Marc R. Sarni*

Mr. Sarni, age 47, has served as a member of our board of directors since June 2004. Mr. Sarni is a Principal at Cornerstone Investment, LLC, a group engaged in the investment in, and development and property management of, both residential and commercial real estate. Mr. Sarni worked as an investment banker at A.G.

Edwards and Sons, Inc. for 17 years, and from 1997 until 2003 Mr. Sarni was the Managing Director responsible for establishing and managing the Healthcare Industry Group within the corporate finance department's Emerging Growth Sector. The Healthcare Industry Group of A.G. Edwards focused primarily on emerging growth medical technology, biotechnology, specialty pharmaceutical and healthcare services companies. Prior to joining A.G. Edwards, Mr. Sarni spent three years working as a Certified Public Accountant at PriceWaterhouse (now PricewaterhouseCoopers LLP). Mr. Sarni currently serves as a member of the Boards of Directors of Young Innovation, Inc., a manufacturer and marketer of dental products and equipment, Microtek Medical Holdings, Inc., a developer of infection and fluid control, safety, and other medical products directed at the healthcare industry, and Managers for Ascension Health Ventures, the strategic health venture-investing subsidiary of Ascension Health, the nation's largest Catholic and not-for-profit healthcare system. Mr. Sarni graduated from the University of Missouri at Columbia with a BSBA degree in Accounting and from the University of Chicago with an M.B.A. in Finance.

**DIRECTORS CONTINUING IN OFFICE UNTIL THE 2008 ANNUAL MEETING**

*Thomas C. Merigan, Jr., M.D.*

Dr. Merigan, age 72, became a scientific advisor and director of Hollis-Eden in March 1996. Dr. Merigan was George E. and Lucy Becker Professor of Medicine at Stanford University School of Medicine from 1980 to 2004. He continues to hold the chair as an active emeritus professor. Dr. Merigan has also been the Principal Investigator, NIAID Sponsored AIDS Clinical Trials Unit, from 1986 to the present, and has been Director of Stanford University's Center For AIDS Research from 1988 to the present. Dr. Merigan is a member of various medical and honorary societies, has lectured extensively within and outside the United States, and authored numerous books and articles and has chaired and edited symposia relating to infectious diseases, including anti-viral agents, HIV and other retroviruses, and AIDS. From 1990 to the present, Dr. Merigan has been Chairman, Editorial Board of *HIV: Advances in Research and Therapy*. He is also a member of the editorial boards of *Aids Research and Human Retroviruses* (since 1983), *International Journal of Anti-Microbial Agents* (since 1990), and *The Aids Reader* (since 1991), among others. He is a co-recipient of ten patents, which, among other things, relate to synthetic polynucleotides, modification of hepatitis B virus infection, treatment of HIV infection, purified cytomegalovirus protein and composition and treatment for herpes simplex. Dr. Merigan was Chair, Immunology AIDS Advisory Board, Bristol Myers Squibb Corporation from 1989 to 1995 and Chair, Scientific Advisory Board, Sequel Corp. from 1993 to 1996. In 1994, Stanford University School of Medicine honored him with the establishment of the Annual Thomas C. Merigan Jr. Endowed Lectureship in Infectious Diseases, and, in 1996, Dr. Merigan was elected Fellow, American Association for the Advancement of Science. From 1966 to 1992, Dr. Merigan was Head, Division of Infectious Diseases, at Stanford School of Medicine. Dr. Merigan received his B.A. from the University of California at Berkeley and his M.D. from the University of California at San Francisco.

*Brendan R. McDonnell*

Mr. McDonnell, age 43, has served as a member of our board of directors since August 1996. In 2003, Mr. McDonnell joined the law firm Preston Gates & Ellis LLP as an equity partner and serves as Practice Group Leader. From 1997 to 2003, Mr. McDonnell was of counsel and then a partner at Tonkon Torp LLP, a Northwest based law firm. Mr. McDonnell specializes in representing both private and public emerging growth companies, with focus on the high technology industry. Mr. McDonnell is the past Chair of the Business Section of the Oregon State Bar and spent two years as an adjunct professor at the Northwestern School of Law of Lewis and Clark College. Mr. McDonnell holds a B.S. in accounting from Loyola Marymount University and a J.D. from the University of California at Davis. He is a member of the California, Oregon and Washington State Bar Associations.

**INDEPENDENCE OF THE BOARD OF DIRECTORS**

As required under the Nasdaq Stock Market (Nasdaq) listing standards, a majority of the members of a listed company's board of directors must qualify as independent, as affirmatively determined by the company's

board of directors. After review of all relevant transactions and relationships between each director, or any of his or her family members, and us, our senior management and our independent registered public accounting firm, our board affirmatively has determined that Messrs. Bagley, Sarni, Zizza, Merigan, Hauer and McDonnell are independent directors within the meaning of the Nasdaq listing standards.

#### **INFORMATION REGARDING OUR BOARD OF DIRECTORS AND ITS COMMITTEES**

During 2005, our board of directors held eight meetings. Each board member attended at least 75% of the aggregate number of meetings of our board and of the committees on which he served, held during the period for which he was a director or committee member, respectively.

In April 2004, our board of directors documented our corporate governance practices by adopting a number of corporate governance policies and procedures, as well as a Nominating Committee Charter and a Business Code of Conduct and Ethics, to assure that our board will have the necessary authority and practices in place to make decisions that are independent of our management. In June 2005, our board amended the charter and renamed the committee to be the Nominating and Corporate Governance Committee. These guidelines are also intended to align the interests of our directors and management with those of our stockholders. These guidelines set forth the practices our board will follow with respect to board composition and selection, board meetings and the involvement of our senior management, Chief Executive Officer performance evaluation, and board committees and compensation. These policies and procedures, together with the Nominating and Corporate Governance Committee Charter and Business Code of Conduct and Ethics, were adopted by our board to, among other things, reflect changes to the Nasdaq listing standards and Securities and Exchange Commission rules adopted to implement provisions of the Sarbanes-Oxley Act of 2002. In March 2006, our board of directors selected Mr. Zizza to serve as Lead Independent Director of our board of directors. The Lead Independent Director's duties include, to the extent appropriate, leading executive sessions of our board's independent directors, assisting our Chief Executive Officer with communications with our stockholders, and facilitating communications between the other members of our board of directors.

As required under the Nasdaq listing standards, our independent directors meet in regularly scheduled executive sessions at which only independent directors are present. Mr. Zizza, as the Lead Independent Director, will preside over the executive sessions.

#### **Nominating and Corporate Governance Committee**

Our board of directors has adopted a Nominating and Corporate Governance Committee Charter, which can be found on our corporate website at [www.holliseden.com](http://www.holliseden.com). The Nominating and Corporate Governance Committee (Nominating Committee) is composed of three directors who are independent (as independence is currently defined in Rule 4200(a)(15) of the Nasdaq listing standards): Messrs. Zizza, Hauer and McDonnell. The Nominating Committee is responsible for identifying, reviewing and evaluating candidates to serve as our directors (consistent with criteria approved by our board), reviewing and evaluating incumbent directors, recommending to our board candidates for election to our board, assessing the performance of our board, and making recommendations to our board regarding the membership of the committees of our board. The Nominating Committee held one meeting in 2005.

Our board of directors believes that candidates for director should have certain minimum qualifications, including: personal integrity and ethics; no interests that would materially impair his or her ability to exercise independent judgment and otherwise discharge his or her fiduciary duties; ability to represent all stockholders equally; achievement in one or more fields of business, professional, governmental, scientific or educational endeavor; sound judgment based on management or policy-making experience; general understanding of the major issues facing public companies of a similar size and operational scope as us; and ability to devote adequate time to our board and its committees. However, the Nominating Committee retains the right to modify these qualifications from time to time. Candidates for director nominees are reviewed in the context of the current composition of our board, our operating requirements and the long-term interests of our stockholders. In

conducting this assessment, the Nominating Committee considers such factors as it deems appropriate given our current needs and the current needs of our board, to maintain a balance of knowledge, experience and capability. In the case of incumbent directors whose terms of office are set to expire, the Nominating Committee reviews such directors' overall service during their term, including the number of meetings attended, level of participation, quality of performance, and any other relationships and transactions that might impair such directors' independence. In the case of new director candidates, the Nominating Committee will also determine whether the nominee must be independent for Nasdaq purposes, which determination is based upon applicable Nasdaq listing standards and applicable Securities and Exchange Commission rules and regulations. The Nominating Committee will then compile a list of potential candidates, using its own network of contacts, as well as recommendations from other board members and management. The Nominating Committee may also engage, if appropriate under the circumstances, a professional search firm to assist in identifying qualified candidates. The Nominating Committee will conduct any appropriate or necessary inquiries into the backgrounds and qualifications of possible candidates after considering the function and needs of our board. The Nominating Committee will meet to discuss and consider such candidates' qualifications and then select nominees for recommendation to our board by majority vote.

The Nominating Committee will consider director candidates recommended by our stockholders. The Nominating Committee will accept for consideration only one recommendation from any stockholder or affiliated group of stockholders. The Nominating Committee will also take into account the size and duration of the recommending stockholder's ownership interest in the Company and the extent to which such stockholder intends to maintain its ownership interest in the Company. Our board of directors does not intend for the Nominating Committee to alter the manner in which it evaluates candidates, including the minimum criteria set forth above, based on whether or not the candidate was recommended by a stockholder. Stockholders who wish to recommend individuals for consideration by the Nominating Committee to become nominees for election to our board may do so by delivering a written recommendation to the Nominating Committee at the following address: 4435 Eastgate Mall, Suite 400, San Diego, California 92121, 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 the written consent of the proposed nominee to be named as a nominee and to serve as a director if elected. Any such submission must be accompanied by a representation that the nominating stockholder is a beneficial or record owner of our common stock, including the number of shares and when the shares were acquired, and the extent to which the nominating stockholder intends to maintain its ownership interest in the Company.

Notwithstanding the responsibilities of the Nominating Committee described above, the recommendations for director nominees made by the Nominating Committee will be subject to Delaware law, our bylaws and the provisions of an employment agreement, dated November 1, 1996, between us and Richard B. Hollis. Pursuant to that agreement, Mr. Hollis has the right, under specified circumstances, to require us to nominate him and two of his designees for election to our board. To date, however, Mr. Hollis has not exercised this right.

#### **Compensation Committee**

The Compensation Committee makes recommendations to our board of directors concerning executive salaries and incentive compensation, administers our 2005 Equity Incentive Plan and 2005 Non-Employee Directors' Equity Incentive Plan and otherwise determines compensation levels and policies and performs such other functions regarding compensation as our board may delegate. The Compensation Committee is composed of three independent non-employee directors who are independent (as independence is currently defined in Rule 4200 (a)(15) of the Nasdaq listing standards): Messrs. McDonnell, Bagley and Sarni. The Compensation Committee had five meetings in 2005.

### **Audit Committee**

The Audit Committee oversees our corporate accounting and financial reporting process. For this purpose, the Audit Committee performs several functions. The Audit Committee evaluates the performance and assesses the qualifications of the independent auditor; determines the engagement of the independent auditor; determines whether to retain or terminate the existing independent auditor or to appoint and engage a new independent auditor; reviews and approves the retention of the independent auditor to perform any proposed non-permissible audit services; and monitors the rotation of partners of the independent auditor on our engagement team as required by law. The Audit Committee meets and reviews with management and the independent auditors: the quarterly financial statements and disclosures prior to the filing of our Quarterly Reports on Form 10-Q; the financial statements and disclosures to be included in our Annual Report on Form 10-K; our policies with respect to risk assessment and risk management; our internal controls; and the results of the annual audit. The Audit Committee is composed of three directors and operates under a written charter adopted by our board of directors. Our board of directors reviews and assesses the adequacy of the Audit Committee's written charter on an annual basis in light of applicable Nasdaq and Securities and Exchange Commission rules and regulations. The members of the Audit Committee are Messrs. Bagley, Sarni and Zizza. Our board of directors also annually reviews the definition of independence under the Nasdaq listing standards and Securities and Exchange Commission rules and regulations for Audit Committee members and has determined that all members of our Audit Committee are independent (as independence is currently defined in Rule 4350(d)(2)(A)(i) and (ii) of the Nasdaq listing standards and Section 10A of the Securities Exchange Act of 1934, as amended). Each member of the Audit Committee is financially literate, knowledgeable and qualified to review financial statements. The Audit Committee Financial Expert designated by our board (as that term is defined in the rules and regulations established by the Securities and Exchange Commission) is Mr. Zizza. Our board of directors made a qualitative assessment of Mr. Zizza's level of knowledge and experience based on a number of factors, including his formal education and experience as a chief financial officer. The Audit Committee had ten meetings in 2005.

### **STOCKHOLDER COMMUNICATIONS WITH OUR BOARD OF DIRECTORS**

Our board of directors has adopted a formal process by which our stockholders may communicate with our board. Persons interested in communicating with our board with their concerns or issues may address correspondence to our board, in care of Hollis-Eden Pharmaceuticals, Inc., at 4435 Eastgate Mall, Suite 400, San Diego, California 92121. All such communications will be compiled by our secretary and submitted to our board on a periodic basis. All communications must be accompanied by the following information:

A statement as to (i) the number of shares of our common stock that the person holds and (ii) the approximate date on which the person became a stockholder;

Any special interest, meaning an interest not in the capacity as one of our stockholders, of the person in the subject matter of the communication; and

The address, telephone number and e-mail address, if any, of the person submitting the communication.

The following types of communications are not appropriate for delivery to directors under these procedures:

Communications regarding individual grievances or other interests that are personal to the party submitting the communication and would not reasonably be of concern to stockholders generally;

Communications that advocate Hollis-Eden engaging in illegal, unethical or otherwise improper activities;

Communications that contain offensive, vulgar or abusive content; and

Communications that have no rational relevance to our business or operations.





**CODE OF BUSINESS CONDUCT AND ETHICS**

We have adopted the Hollis-Eden Pharmaceuticals Code of Business Conduct and Ethics, which applies to all officers, directors and employees. The Code of Business Conduct and Ethics is available on our website at [www.holliseden.com](http://www.holliseden.com). If we make any substantive amendments to the Code of Business Conduct and Ethics or grant any waiver from a provision of the Code to any executive officer or director, we will promptly disclose the nature of the amendment or waiver in a Form 8-K filed with the Securities and Exchange Commission.

**REPORT OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS**

Our board of directors maintains an Audit Committee composed of three directors who meet the independence and the financial literacy requirements of the applicable Securities and Exchange Commission rules and regulations. Our board has determined that Mr. Salvatore Zizza qualifies as an Audit Committee Financial Expert under the applicable Securities and Exchange Commission rules and regulations. During 2005, the Audit Committee held ten meetings. Our board has also adopted a written charter of the Audit Committee.

Management is responsible for our systems of internal controls and the financial reporting process. The independent auditor is responsible for performing an independent audit of our financial statements and to attest to management's assessment of internal controls in accordance with generally accepted auditing standards and Section 404 of the Sarbanes Oxley Act of 2002, respectively, and to issue reports thereon. The Audit Committee's responsibility is to monitor and oversee these processes on behalf of our board of directors.

Our independent auditor also provided to the Audit Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees), and the Audit Committee discussed with the independent auditor that firm's independence.

Based on the Audit Committee's discussion with management and the independent auditor as well as the Audit Committee's review of the representation of management and the report of the independent auditor to the Audit Committee, the Audit Committee recommended that our board of directors include the audited financial statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005 filed with the Securities and Exchange Commission.

The information contained in this report shall not be deemed to be soliciting material or to be filed with the Securities and Exchange Commission nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933, as amended or the Securities Exchange Act of 1934, as amended, except to the extent that we specifically incorporate it by reference in any such filing.

Respectfully submitted by:

AUDIT COMMITTEE

Paul Bagley, Chairman

Marc R. Sarni

Salvatore J. Zizza

**Proposal 2**

**AMENDMENT TO THE 2005 EQUITY INCENTIVE PLAN**

On April 27, 2005, our board of directors adopted the Hollis-Eden Pharmaceuticals, Inc. 2005 Equity Incentive Plan (the "2005 Equity Plan"). Our stockholders approved the 2005 Equity Plan in June 2005. The 2005 Equity Plan is an amendment and restatement of Hollis-Eden Pharmaceuticals' 1997 Incentive Stock Option Plan (the "1997 Option Plan"). Options granted under the 1997 Option Plan prior to its amendment and restatement are subject to the terms and conditions as set forth in the agreements evidencing such options and the terms of the 1997 Option Plan except that our board may elect to extend one or more of the features of the 2005 Equity Plan to stock awards granted under the 1997 Option Plan. The approval of the adoption of the 2005 Equity Plan increased the number of shares of our common stock reserved for issuance beyond those reserved for issuance under the 1997 Option Plan by 350,000 shares for a total of 5,500,000 reserved shares.

In December 2005, our board amended the 2005 Equity Plan to reserve an additional 100,000 shares to be used only for the grant of stock awards to persons not previously employed by us, or following a bona fide period of non-employment, as an inducement material to those persons entering into employment with us within the meaning of Rule 4350(i)(1)(A)(iv) of the Nasdaq Marketplace Rules, and to provide that any such inducement awards must be granted either by a majority of our independent directors or a committee comprised of a majority of independent directors. Stockholder approval is not required for the amendment of the 2005 Equity Plan to reserve an additional 100,000 shares to be used for inducement awards.

On March 18, 2006, our board of directors amended and restated the 2005 Equity Plan to reserve an additional 500,000 shares for issuance, subject to approval by our stockholders at this annual meeting.

This Proposal 2 seeks an increase in the number of shares that may be issued under the 2005 Equity Plan by 500,000 shares. The additional 500,000 shares will increase the total shares of common stock reserved for issuance under the 2005 Equity Plan to an aggregate of 6,100,000. At March 31, 2006, options (net of cancelled, forfeited and exercised options) covering an aggregate of 4,940,666 shares had been granted under the 2005 Equity Plan and the 1997 Option Plan, and 382,253 shares (plus any shares that might in the future be returned to the 2005 Equity Plan and the 1997 Option Plan as a result of cancellations or expiration of options) remained available for future grant under the 2005 Equity Plan.

The approval of the amendment to the 2005 Equity Plan will allow us to continue to grant stock options and other awards at levels determined appropriate by our board of directors. Because we are approaching the latter stages of development for our lead compound, NEUMUNE, we will likely need to increase our employee base. During this hiring period, our board believes it is important for us to have the ability to grant a sufficient number of stock options to attract the most qualified employees in the industry. Accordingly, the approval of the amendment to the 2005 Equity Plan will allow us flexibility in attracting and retaining qualified personnel by granting stock options and other awards to employees, directors and consultants at levels determined appropriate by our board and the Compensation Committee.

Our stockholders are requested in this Proposal 2 to approve the 2005 Equity Plan, as amended. The affirmative vote of the holders of a majority of the shares present in person or represented by proxy and entitled to vote at the annual meeting will be required to approve the 2005 Equity Plan, as amended. Abstentions will be counted toward the tabulation of votes cast on proposals presented to the stockholders and will have the same effect as negative votes. Broker non-votes are counted towards a quorum, but are not counted for any purpose in determining whether this matter has been approved.

**OUR BOARD OF DIRECTORS RECOMMENDS A VOTE IN FAVOR OF PROPOSAL 2.**

The full text of the 2005 Equity Plan, substantially in the form in which it will take effect if the proposed amendment is approved by our stockholders, is set forth in Appendix A to this proxy statement. The following summary of the principal features of the 2005 Equity Plan is subject to, and qualified in its entirety by, the full text of the 2005 Equity Plan in Appendix A.

**General**

The 2005 Equity Plan provides for the grant of incentive stock options, nonstatutory stock options, stock appreciation rights, stock purchase awards, restricted stock awards, restricted stock unit awards, and other forms of equity compensation (collectively, "stock awards"). Incentive stock options granted under the 2005 Equity Plan are intended to qualify as incentive stock options within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"). Nonstatutory stock options granted under the 2005 Equity Plan are not intended to qualify as incentive stock options under the Code. See "Federal Income Tax Information" for a discussion of the tax treatment of stock awards.

**Purpose**

Our board adopted the 2005 Equity Plan to provide a means to secure and retain the services of employees (including officers), consultants and directors eligible to receive stock awards, to provide incentives for such individuals to exert maximum efforts for the success of Hollis-Eden and its affiliates, and to provide a means by which such eligible individuals may be given an opportunity to benefit from increases in the value of Hollis-Eden's common stock through the grant of stock awards.

**Administration**

Our board administers the 2005 Equity Plan. Subject to the provisions of the 2005 Equity Plan, our board has the authority to construe and interpret the plan, to determine the persons to whom and the dates on which stock awards will be granted, the number of shares of common stock to be subject to each stock award, the time or times during the term of each stock award within which all or a portion of the award may be exercised, the exercise, purchase, or strike price of each stock award, the type of consideration permitted to exercise or purchase each stock award, and other terms of the stock awards.

Our board has the authority to delegate some or all of the administration of the 2005 Equity Plan to a committee or committees. In the discretion of our board, a committee may consist solely of two or more non-employee directors within the meaning of Rule 16b-3 of the Securities Exchange Act of 1934, as amended, or solely of two or more outside directors within the meaning of Section 162(m) of the Code. Our board has delegated administration of the 2005 Equity Plan to the Compensation Committee of our board. If administration is delegated to a committee, the committee has the authority to delegate certain administrative powers to a subcommittee of one or more members. As used herein with respect to the 2005 Equity Plan, "our board" refers to any committee our board appoints or, if applicable, any subcommittee, as well as to our board itself.

**Eligibility**

Incentive stock options may be granted under the 2005 Equity Plan only to employees (including officers) of Hollis-Eden and its affiliates. Employees (including officers), consultants and directors of Hollis-Eden and its affiliates are eligible to receive all other types of stock awards under the 2005 Equity Plan. All employees, consultants and directors of Hollis-Eden and its affiliates are eligible to participate in the 2005 Equity Plan.

No incentive stock option may be granted under the 2005 Equity Plan to any person who, at the time of the grant, owns (or is deemed to own) stock possessing more than 10% of the total combined voting power of Hollis-Eden or its affiliates, unless the exercise price of such option is at least 110% of the fair market value of the stock

subject to the option on the date of grant and the term of the option does not exceed five years from the date of grant. In addition, the aggregate fair market value, determined on the date of grant, of the shares of common stock with respect to which incentive stock options are exercisable for the first time by a participant during any calendar year (under the 2005 Equity Plan and any other plans of Hollis-Eden and its affiliates) may not exceed \$100,000.

Under the 2005 Equity Plan, except with respect to inducement awards (see *Inducement Awards* below), no person may be granted stock awards whose value is determined by reference to an increase over an exercise or strike price of at least 100% of the fair market value of the common stock on the date of grant under the 2005 Equity Plan covering more than 250,000 shares of common stock during any calendar year (the *Section 162(m) Limitation* ).

### **Stock Subject to the 2005 Equity Plan**

Subject to stockholder approval of this proposal, an aggregate of 6,100,000 shares of common stock are reserved for issuance under the 2005 Equity Plan, which includes 5,150,000 shares of common stock previously reserved for issuance under the 1997 Option Plan, 350,000 shares approved by our stockholders at the 2005 annual meeting of stockholders, 100,000 shares ( *inducement shares* ) separately reserved for issuance as *inducement awards* , plus an additional 500,000 shares. If a stock award granted under either the 2005 Equity Plan or the 1997 Option Plan expires or otherwise terminates without being exercised in full, or if any shares of common stock issued pursuant to a stock award are forfeited to or repurchased by Hollis-Eden, including, but not limited to, any repurchase or forfeiture caused by the failure to meet a contingency or condition required for the vesting of such shares, then the shares of common stock not issued under such stock award, or forfeited to or repurchased by Hollis-Eden shall revert to and again become available for issuance under the 2005 Equity Plan. If any shares subject to a stock award are not delivered to a participant because such shares are withheld for the payment of taxes or the stock award is exercised through a reduction of shares subject to the stock award (i.e., *net exercised* ), the number of shares that are not delivered shall remain available for issuance under the 2005 Equity Plan. If the exercise price of any stock award is satisfied by tendering shares of common stock held by the participant, then the number of shares so tendered shall remain available for issuance under the 2005 Equity Plan. Inducement shares that revert to, or remain available for subsequent issuance under, the 2005 Equity Plan may only be granted to the persons described below (see *Inducement Awards* ). The aggregate maximum number of shares of common stock that may be issued under the 2005 Equity Plan pursuant to the exercise of incentive stock options is 6,000,000 shares plus the amount of any future increase in the number of shares that may be available for issuance under the 2005 Equity Plan. Inducement shares (see *Inducement Awards* below) may not be used to grant awards of incentive stock options.

As of April 13, 2006, the closing price of our common stock as reported on the Nasdaq National Market was \$5.68 per share.

### **Terms of Options**

Options may be granted under the 2005 Equity Plan pursuant to stock option agreements. The following is a description of the permissible terms of options under the 2005 Equity Plan. Individual stock option agreements may be more restrictive as to any or all of the permissible terms described below.

*Exercise Price.* The exercise price of incentive stock options may not be less than 100% of the fair market value of the stock subject to the option on the date of grant and, in some cases (see *Eligibility* above), may not be less than 110% of such fair market value. The exercise price of nonstatutory stock options may not be less than 100% of the fair market value of the stock on the date of grant.

*Consideration.* The exercise price of options granted under the 2005 Equity Plan must be paid, to the extent permitted by applicable law and at the discretion of our board, (i) by cash or check, (ii) pursuant to a broker-

assisted cashless exercise, (iii) by delivery of other common stock of Hollis-Eden, (iv) pursuant to a net exercise arrangement, or (iv) in any other form of legal consideration acceptable to our board.

*Vesting.* Options granted under the 2005 Equity Plan may become exercisable in cumulative increments, or vest, as determined by our board. Vesting typically will occur during the optionholder's continued service with Hollis-Eden or an affiliate, whether such service is performed in the capacity of an employee, consultant or director (collectively, service) and regardless of any change in the capacity of the service performed. Shares covered by different options granted under the 2005 Equity Plan may be subject to different vesting terms. The Board has the authority to accelerate the time during which an option may vest or be exercised. In addition, options granted under the 2005 Equity Plan may permit exercise prior to vesting. However, any unvested shares acquired under such an early exercise arrangement will be subject to repurchase by Hollis-Eden, should the participant's service terminate before vesting.

*Tax Withholding.* To the extent provided by the terms of a stock option agreement, a participant may satisfy any federal, state or local tax withholding obligation relating to the exercise of the option by a cash payment upon exercise, by authorizing Hollis-Eden to withhold a portion of the stock otherwise issuable to the participant, by delivering already-owned common stock of Hollis-Eden, or by a combination of these means.

*Term.* The maximum term of options granted under the 2005 Equity Plan is 10 years, except that in certain cases (see Eligibility above) the maximum term is five years.

*Termination of Service.* Options granted under the 2005 Equity Plan generally terminate three months after termination of the participant's service unless (i) termination is due to the participant's disability, in which case the option may be exercised (to the extent the option was exercisable at the time of the termination of service) at any time within 12 months following termination; (ii) the participant dies before the participant's service has terminated, or within generally three months after termination of service, in which case the option may be exercised (to the extent the option was exercisable at the time of the participant's death) within 18 months following the participant's death by the person or persons to whom the rights to such option have passed; or (iii) the option by its terms specifically provides otherwise. Under the 2005 Equity Plan, the option term may be extended in the event that exercise of the option following termination of service is prohibited by applicable securities laws.

*Restrictions on Transfer.* Unless provided otherwise by our board, a participant in the 2005 Equity Plan may not transfer an option other than by will or by the laws of descent and distribution or pursuant to a domestic relations order and during the lifetime of the participant, only the participant (or the transferee pursuant to a domestic relations order) may exercise an option. A participant may also designate a beneficiary who may exercise an option following the participant's death.

### **Terms of Stock Appreciation Rights**

Stock appreciation rights may be granted under the 2005 Equity Plan pursuant to stock appreciation rights agreements.

*Exercise.* Each stock appreciation right is denominated in shares of common stock equivalents. Upon exercise of a stock appreciation right, Hollis-Eden will pay the participant an amount equal to the excess of (i) the aggregate fair market value of Hollis-Eden's common stock on the date of exercise, over (ii) the strike price determined by our board on the date of grant.

*Settlement of Awards.* The appreciation distribution upon exercise of a stock appreciation right may be paid in cash, shares of Hollis-Eden's common stock, or any other form of consideration determined by our board.

*Vesting.* Stock appreciation rights vest and become exercisable at the rate specified in the stock appreciation right agreement as determined by our board.

*Termination of Service.* Upon termination of a participant's service, the participant generally may exercise any vested stock appreciation right for three months (or such longer or shorter period specified in the stock appreciation right agreement) after the date such service relationship ends. In no event may a stock appreciation right be exercised beyond the expiration of its term.

#### **Terms of Stock Purchase Awards and Restricted Stock Awards**

Stock purchase awards and restricted stock awards may be granted under the 2005 Equity Plan pursuant to stock purchase award agreements and restricted stock award agreements, respectively.

*Purchase Price.* The purchase price for stock purchase awards must be at least the par value of Hollis-Eden's common stock.

*Consideration.* The purchase price for stock purchase awards may be payable either (i) in cash or by check, (ii) by past service rendered to Hollis-Eden, or (iii) in any other form of legal consideration acceptable to our board. Our board may grant restricted stock awards in consideration for past services rendered to Hollis-Eden or in exchange for any other form of legal consideration acceptable to our board, without the payment of a purchase price.

*Vesting.* Shares of stock acquired under a stock purchase or restricted stock award may, but need not, be subject to a repurchase option in favor of Hollis-Eden or forfeiture to Hollis-Eden in accordance with a vesting schedule as determined by our board. Our board has the authority to accelerate the vesting of stock acquired pursuant to a stock purchase or restricted stock award.

*Termination of Service.* Upon termination of a participant's service, Hollis-Eden may repurchase or otherwise reacquire any forfeited shares of stock that have not vested as of such termination under the terms of the applicable stock purchase award or restricted stock award agreement.

*Restrictions on Transfer.* Rights to acquire shares under a stock purchase or restricted stock award may be transferred only upon such terms and conditions as determined by our board.

#### **Terms of Restricted Stock Unit Awards**

Restricted stock unit awards may be granted under the 2005 Equity Plan pursuant to restricted stock unit award agreements.

*Consideration.* The purchase price, if any, for restricted stock unit awards may be paid in any form of legal consideration acceptable to our board.

*Settlement of Awards.* A restricted stock unit award may be settled by the delivery of shares of Hollis-Eden's common stock, in cash, or by any combination of these means as determined by our board.

*Vesting.* Restricted stock unit awards vest at the rate specified in the restricted stock unit award agreement as determined by our board. However, at the time of grant, our board may impose additional restrictions or conditions that delay the delivery of stock or cash subject to the restricted stock unit award after vesting.

*Dividend Equivalents.* Dividend equivalent rights may be credited with respect to shares covered by a restricted stock unit award. Hollis-Eden does not anticipate paying cash dividends on its common stock for the foreseeable future, however.

*Termination of Service.* Except as otherwise provided in the applicable award agreement, restricted stock units that have not vested will be forfeited upon the participant's termination of service.

### Terms of Other Equity Awards

Our board may grant other equity awards that are valued in whole or in part by reference to Hollis-Eden's common stock. Subject to the provisions of the 2005 Equity Plan, our board has the authority to determine the persons to whom and the dates on which such other equity awards will be granted, the number of shares of common stock (or cash equivalents) to be subject to each award, and other terms and conditions of such awards.

### Performance-Based Stock Awards

Under the 2005 Equity Plan, a stock award may be granted, vest or be exercised based upon certain service conditions or upon the attainment during a certain period of time of certain performance goals. All employees, consultants and directors of Hollis-Eden and its affiliates are eligible to receive performance-based stock awards under the 2005 Equity Plan. The length of any performance period, the performance goals to be achieved during the performance period, and the measure of whether and to what degree such performance goals have been attained shall be determined by our board. The maximum amount to be received by any individual in any calendar year attributable to such performance-based stock awards may not exceed 250,000 shares of Hollis-Eden's common stock.

In granting a performance-based stock award, our board will set a period of time (a performance period) over which the attainment of one or more goals (performance goals) will be measured for the purpose of determining whether the award recipient has a vested right in or to such stock award. Within the time period prescribed by Section 162(m) of the Code (typically before the 90th day of a performance period), our board will establish the performance goals, based upon one or more pre-established criteria (performance criteria) enumerated in the 2005 Equity Plan and described below. As soon as administratively practicable following the end of the performance period, our board will certify (in writing) whether the performance goals have been satisfied.

Performance goals under the 2005 Equity Plan shall be determined by our board, based on a service condition or on one or more of the following performance criteria: (i) earnings per share; (ii) earnings before interest, taxes and depreciation; (iii) earnings before interest, taxes, depreciation and amortization; (iv) total stockholder return; (v) return on equity; (vi) return on assets, investment, or capital employed; (vii) operating margin; (viii) gross margin; (ix) operating income; (x) net income (before or after taxes); (xi) net operating income; (xii) net operating income after tax; (xiii) pre-tax profit; (xiv) operating cash flow; (xv) sales or revenue targets; (xvi) increases in revenue or product revenue; (xvii) expenses and cost reduction goals; (xviii) improvement in or attainment of working capital levels; (xix) economic value added (or an equivalent metric); (xx) market share; (xxi) cash flow; (xxii) cash flow per share; (xxiii) share price performance; (xxiv) debt reduction; (xxv) implementation or completion of projects or processes; (xxvi) customer satisfaction; (xxvii) stockholders' equity; and (xxviii) to the extent that an award is not intended to comply with Section 162(m) of the Code, other measures of performance selected by our board.

At the time of the grant of any stock award under the 2005 Equity Plan, our board is authorized to determine whether, when calculating attainment of performance goals and objectives for a performance period: (a) to exclude restructuring and/or other nonrecurring charges; (b) to exclude exchange rate effects, as applicable, for non-U.S. dollar denominated net sales and operating earnings; (c) to exclude the effects of changes to generally accepted accounting standards required by the Financial Accounting Standards Board; (d) to exclude the effects to any statutory adjustments to corporate tax rates; and (e) to exclude the impact of any extraordinary items as determined under generally accepted accounting principles.

Compensation attributable to performance-based stock awards under the 2005 Equity Plan will generally qualify as performance-based compensation, provided that: (i) the award is granted by a compensation committee comprised solely of outside directors, (ii) the award is granted (or exercisable) only upon the achievement of an objective performance goal established in writing by the compensation committee while the outcome is substantially uncertain, (iii) the Compensation Committee certifies in writing prior to the granting (or exercisability) of the award that the performance goal has been satisfied.



### **Inducement Awards**

Our board may grant stock awards (other than incentive stock options) covering the 100,000 shares reserved under the 2005 Equity Plan as inducement shares to employees not previously employed by us or directors of Hollis-Eden as inducements material to the individuals entering into employment with us within the meaning of Rule 4350(i)(1)(A)(iv) of the Nasdaq Marketplace Rules (inducement awards). All such inducement awards must be granted either by a majority of our independent directors or a committee comprised of a majority of independent directors.

### **Changes to Capital Structure**

If any change is made to the outstanding shares of Hollis-Eden's common stock without Hollis-Eden's receipt of consideration (whether through a stock split or other specified change in the capital structure of Hollis-Eden), appropriate adjustments will be made to: (i) the maximum number and/or class of securities issuable under the 2005 Equity Plan, (ii) the maximum number and/or class of securities that may be issued pursuant to the exercise of incentive stock options, (iii) the maximum number and/or class of securities for which any one person may be granted options and/or stock appreciation rights or performance-based stock awards per calendar year pursuant to the Section 162(m) Limitation, and (iv) the number and/or class of securities and the price per share in effect under each outstanding stock award under the 2005 Equity Plan.

### **Corporate Transactions; Changes in Control**

Under the 2005 Equity Plan, unless otherwise provided in a written agreement between Hollis-Eden or any affiliate and the holder of the stock award, in the event of a corporate transaction (as defined in the 2005 Equity Plan), all outstanding stock awards under the 2005 Equity Plan may be assumed, continued or substituted for by any surviving or acquiring entity (or its parent company). If the surviving or acquiring entity (or its parent company) elects not to assume, continue or substitute for such stock awards, then (i) with respect to any such stock awards that are held by individuals whose continuous service with Hollis-Eden or its affiliates has not terminated prior to the effective date of the corporate transaction, the vesting and exercisability provisions of such stock awards will be accelerated in full and such awards will terminate if not exercised prior to the effective date of the corporate transaction, and (ii) with respect to any stock awards that are held by individuals whose continuous service with Hollis-Eden or its affiliates has terminated prior to the effective date of the corporate transaction, the vesting and exercisability provisions of such stock awards will not be accelerated and such awards will terminate if not exercised prior to the effective date of the corporate transaction (except that any reacquisition or repurchase rights held by Hollis-Eden with respect to such stock awards shall not terminate and may continue to be exercised notwithstanding the corporate transaction). In the event a stock award will terminate if not exercised, our board may provide, in its sole discretion, that the holder of such stock award may not exercise such stock award but will receive a payment equal to the excess of the value of the property the holder would have received upon exercise over any exercise price.

Other stock awards, such as stock purchase awards, may have their repurchase or forfeiture rights assigned to the surviving or acquiring entity (or its parent company) in the corporate transaction. If such repurchase or forfeiture rights are not assigned, then such stock awards will become fully vested.

In addition, each stock award under the 2005 Equity Plan will immediately vest as to all of the shares subject to the stock award upon the occurrence of certain specified change in control transactions (as defined in the 2005 Equity Plan), whether or not such stock award is assumed, continued, or substituted by a surviving or acquiring entity in the transaction.

### **Duration, Termination and Amendment**

Our board may suspend or terminate the 2005 Equity Plan without stockholder approval or ratification at any time. Unless sooner terminated, the 2005 Equity Plan will terminate on April 26, 2015.

Our board may amend or modify the 2005 Equity Plan at any time. However, no amendment shall be effective unless approved by the stockholders of Hollis-Eden to the extent stockholder approval is necessary to satisfy applicable law.

Our board also may submit any other amendment to the 2005 Equity Plan intended to satisfy the requirements of Section 162(m) of the Code regarding the exclusion of performance-based compensation from the limitation on the deductibility of compensation paid to certain employees.

### **Federal Income Tax Information**

The following is a summary of the principal United States federal income taxation consequences to employees and Hollis-Eden with respect to participation in the 2005 Equity Plan. This summary is not intended to be exhaustive, and does not discuss the income tax laws of any city, state or foreign jurisdiction in which a participant may reside.

*Incentive Stock Options.* Incentive stock options granted under the 2005 Equity Plan are intended to be eligible for the favorable federal income tax treatment accorded incentive stock options under the Code. There generally are no federal income tax consequences to the participant or Hollis-Eden by reason of the grant or exercise of an incentive stock option. However, the exercise of an incentive stock option may increase the participant's alternative minimum tax liability, if any.

If a participant holds stock acquired through exercise of an incentive stock option for more than two years from the date on which the option was granted and more than one year after the date the option was exercised for those shares, any gain or loss on a disposition of those shares (a qualifying disposition) will be a long-term capital gain or loss. Upon such a qualifying disposition, Hollis-Eden will not be entitled to any income tax deduction.

Generally, if the participant disposes of the stock before the expiration of either of these holding periods (a disqualifying disposition), then at the time of disposition the participant will realize taxable ordinary income equal to the lesser of (i) the excess of the stock's fair market value on the date of exercise over the exercise price, or (ii) the participant's actual gain, if any, on the purchase and sale. The participant's additional gain or any loss upon the disqualifying disposition will be a capital gain or loss, which will be long-term or short-term depending on whether the stock was held for more than one year.

To the extent the participant recognizes ordinary income by reason of a disqualifying disposition, generally Hollis-Eden will be entitled (subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code, and the satisfaction of a tax reporting obligation) to a corresponding income tax deduction in the tax year in which the disqualifying disposition occurs.

*Nonstatutory Stock Options.* No taxable income is recognized by a participant upon the grant of a nonstatutory stock option. Upon exercise of a nonstatutory stock option, the participant will recognize ordinary income equal to the excess, if any, of the fair market value of the purchased shares on the exercise date over the exercise price paid for those shares. Generally, Hollis-Eden will be entitled (subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code, and the satisfaction of a tax reporting obligation) to a corresponding income tax deduction in the tax year in which such ordinary income is recognized by the participant.

However, if the shares acquired upon exercise of the nonstatutory stock option are unvested and subject to repurchase by Hollis-Eden in the event of the participant's termination of service prior to vesting in those shares, the participant will not recognize any taxable income at the time of exercise, but will have to report as ordinary income, as and when Hollis-Eden's repurchase right lapses, an amount equal to the excess of (i) the fair market value of the shares on the date the repurchase right lapses, over (ii) the exercise price paid for the shares. The participant may, however, elect under Section 83(b) of the Code to include as ordinary income in the year of exercise of the option an amount equal to the excess of (i) the fair market value of the purchased shares on the

exercise date, over (ii) the exercise price paid for such shares. If the Section 83(b) election is made, the participant will not recognize any additional income as and when the repurchase right lapses.

Upon disposition of the stock, the participant will recognize a capital gain or loss equal to the difference between the selling price and the sum of the amount paid for such stock plus any amount recognized as ordinary income upon acquisition (or vesting) of the stock. Such gain or loss will be long-term or short-term depending on whether the stock was held for more than one year.

*Stock Appreciation Rights.* No taxable income is realized upon the receipt of a stock appreciation right. Upon exercise of the stock appreciation right, the fair market value of the shares (or cash in lieu of shares) received is recognized as ordinary income to the participant in the year of such exercise. Generally, with respect to employees, Hollis-Eden is required to withhold from the payment made on exercise of the stock appreciation right or from regular wages or supplemental wage payments an amount based on the ordinary income recognized. Subject to the requirement of reasonableness, Section 162(m) of the Code and the satisfaction of a reporting obligation, Hollis-Eden will be entitled to an income tax deduction equal to the amount of ordinary income recognized by the participant.

*Stock Purchase Awards and Restricted Stock Awards.* Upon receipt of a stock purchase or restricted stock award, the participant will recognize ordinary income equal to the excess, if any, of the fair market value of the shares on the date of issuance over the purchase price, if any, paid for those shares. Hollis-Eden will be entitled (subject to the requirement of reasonableness, the provisions of Section 162(m) of the Code, and the satisfaction of a tax reporting obligation) to a corresponding income tax deduction in the tax year in which such ordinary income is recognized by the participant.

However, if the shares issued upon the grant of a stock purchase or restricted stock award are unvested and subject to repurchase by Hollis-Eden in the event of the participant's termination of service prior to vesting in those shares, the participant will not recognize any taxable income at the time of issuance, but will have to report as ordinary income, as and when Hollis-Eden's repurchase right lapses, an amount equal to the excess of (i) the fair market value of the shares on the date the repurchase right lapses, over (ii) the purchase price, if any, paid for the shares. The participant may, however, elect under Section 83(b) of the Code to include as ordinary income in the year of issuance an amount equal to the excess of (x) the fair market value of the shares on the date of issuance, over (y) the purchase price, if any, paid for such shares. If the Section 83(b) election is made, the participant will not recognize any additional income as and when the repurchase right lapses.

Upon disposition of the stock acquired upon the receipt of a stock purchase or restricted stock award, the participant will recognize a capital gain or loss equal to the difference between the selling price and the sum of the amount paid for such stock plus any amount recognized as ordinary income upon issuance (or vesting) of the stock. Such gain or loss will be long-term or short-term depending on whether the stock was held for more than one year.

*Restricted Stock Unit Awards.* No taxable income is recognized upon receipt of a restricted stock unit award. The participant will recognize ordinary income in the year in which the shares subject to that unit are actually issued to the participant in an amount equal to the fair market value of the shares on the date of issuance. The participant and Hollis-Eden will be required to satisfy certain tax withholding requirements applicable to such income. Subject to the requirement of reasonableness, Section 162(m) of the Code and the satisfaction of a tax reporting obligation, Hollis-Eden will be entitled to an income tax deduction equal to the amount of ordinary income recognized by the participant at the time the shares are issued. In general, the deduction will be allowed for the taxable year in which such ordinary income is recognized by the participant.

*Potential Limitation on Company Deductions.* Section 162(m) of the Code denies a deduction to any publicly-held corporation for compensation paid to certain covered employees in a taxable year to the extent that compensation to such covered employee exceeds \$1 million. It is possible that compensation attributable to awards, when combined with all other types of compensation received by a covered employee from Hollis-Eden, may cause this limitation to be exceeded in any particular year.

Certain kinds of compensation, including qualified performance-based compensation, are disregarded for purposes of the deduction limitation. In accordance with Treasury Regulations issued under Section 162(m) of the Code, compensation attributable to stock options and stock appreciation rights will qualify as performance-based compensation if such awards are granted by a compensation committee comprised solely of outside directors and the plan contains a per-employee limitation on the number of shares for which such awards may be granted during a specified period, the per-employee limitation is approved by the stockholders, and the exercise or strike price of the award is no less than the fair market value of the stock on the date of grant.

Compensation attributable to stock options or stock appreciation rights with exercise or strike prices less than fair market value on the date of grant, stock purchase awards, restricted stock awards, and restricted stock unit awards will qualify as performance-based compensation, provided that: (i) the award is granted by a compensation committee comprised solely of outside directors, (ii) the award is granted (or exercisable) only upon the achievement of an objective performance goal established in writing by the compensation committee while the outcome is substantially uncertain, (iii) the Compensation Committee certifies in writing prior to the granting (or exercisability) of the award that the performance goal has been satisfied, and (iv) prior to the granting (or exercisability) of the award, stockholders have approved the material terms of the award (including the class of employees eligible for such award, the business criteria on which the performance goal is based, and the maximum amount, or formula used to calculate the amount, payable upon attainment of the performance goal).

### New Plan Benefits

The following table presents certain information with respect to options granted under the 2005 Equity Plan during the fiscal year ended December 31, 2005 to (i) our Chief Executive Officer and our other four most highly compensated executive officers in 2005, (ii) all executive officers as a group, (iii) all non-employee directors as a group and (iv) all non-executive officer employees as a group. This information regarding grants for the fiscal year ended December 31, 2005 is for illustration only and may not be indicative of grants that are made in the future under the 2005 Equity Plan. The dollar value of these options cannot be determined because they depend upon the market value of the underlying shares of common stock on the date of exercise.

#### NEW PLAN BENEFITS

##### 2005 Equity Plan

Name and Position	Number of Shares Underlying Options
Mr. Richard B. Hollis	124,800
Chairman of the Board, President and Chief Executive Officer	
Mr. Daniel D. Burgess	39,000
Chief Financial Officer and Chief Operating Officer	
Dr. James M. Frincke	46,800
Chief Scientific Officer	
Mr. Eric J. Loumeau	19,500
Vice President, Corporate General Counsel	
Dr. Christopher L. Reading	19,500
Executive Vice President, Scientific Development	
All Executive Officers as a Group	308,100
All Non-Employee Directors as a Group	
All Non-Executive Officer Employees as a Group	100,296

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**Equity Compensation Plan Information**

The following table provides information as of December 31, 2005 with respect to all of our compensation plans under which we are authorized to issue our equity securities.

<b>Plan Category</b>	<b>(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights</b>	<b>(b) Weighted-average exercise price of outstanding options, warrants and rights</b>	<b>(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</b>
Stock option equity compensation plans approved by security holders	4,676,119	\$ 9.58	870,050
Stock option equity compensation plans not approved by security holders	1,925,700	\$ 7.09	
Warrant equity compensation plans not approved by security holders	796,386	\$ 10.17	

Our equity compensation plans and arrangements adopted without the approval of securities holders that were in effect as of December 31, 2005, and the material features of such plans and arrangements, are described in Note 9 ( Stock Options Non-Plan Options ) and Note 10 ( Common Stock Purchase Warrants ) in the Notes to Financial Statements included in our Annual report on Form 10-K for the year ended December 31, 2005.

**Proposal 3**

**AMENDMENT TO THE 2005 NON-EMPLOYEE DIRECTORS EQUITY INCENTIVE PLAN**

On April 27, 2005, our board of directors adopted the Hollis-Eden Pharmaceuticals, Inc. 2005 Non-Employee Directors Equity Incentive Plan (the 2005 Directors Plan ). The 2005 Directors Plan was approved by our stockholders in June 2005. In December 2005, our board of directors amended the 2005 Directors Plan to refine and clarify certain other provisions of the 2005 Directors Plan to the extent necessary to make the 2005 Directors Plan fully effective. On March 18, 2006, our board of directors amended and restated the 2005 Directors Plan to reserve an additional 150,000 shares for issuance, subject to approval by our stockholders at this annual meeting.

This Proposal 3 seeks to increase the shares of common stock reserved for issuance under the 2005 Directors Plan by 150,000 shares for a total of 300,000 shares reserved for issuance under the 2005 Directors Plan. At March 31, 2006, options covering an aggregate of 150,000 shares had been granted under the 2005 Director s Plan, and no shares (other than any shares that might in the future be returned to the 2005 Directors Plan as a result of cancellations or expirations of options) remained available for future grant under the 2005 Directors Plan.

The approval of the amendment to the 2005 Directors Plan will allow Hollis-Eden to continue to grant stock options and other awards at levels determined appropriate by our board of directors. Because of the increasing time commitments and liability exposure resulting from recent Nasdaq and Securities and Exchange Commission rules and regulations, as well as to bring our board compensation more in line with industry standards, our board believes it is important for us to have the ability to grant a sufficient number of stock options to attract and retain the most qualified non-employee directors in the industry. Accordingly, the approval of the amendment to the 2005 Directors Plan will allow us flexibility in attracting and retaining qualified non-employee directors by granting stock options and other awards to non-employee directors at levels determined appropriate by our board and the Compensation Committee.

Stockholders are requested in this Proposal 3 to approve the 2005 Directors Plan, as amended. The affirmative vote of the holders of a majority of the shares present in person or represented by proxy and entitled to vote at the annual meeting will be required to approve the 2005 Directors Plan, as amended. Abstentions will be counted toward the tabulation of votes cast on proposals presented to the stockholders and will have the same effect as negative votes. Broker non-votes are counted towards a quorum, but are not counted for any purpose in determining whether this matter has been approved.

**OUR BOARD OF DIRECTORS RECOMMENDS A VOTE IN FAVOR OF PROPOSAL 3.**

The full text of the 2005 Directors Plan, substantially in the form in which it will take effect if the proposed amendment is approved by our stockholders, is set forth in Appendix B to this proxy statement. The following summary of the principal features of the 2005 Directors Plan is subject to, and qualified in its entirety by, the full text of the 2005 Directors Plan in Appendix B.

**General**

The 2005 Directors Plan provides for the grant of nonstatutory stock options, stock appreciation rights, stock purchase awards, restricted stock awards, restricted stock unit awards, and other forms of equity compensation (collectively, stock awards ). Any stock awards granted under the 2005 Directors Plan will be granted in the board s discretion. Nonstatutory stock options granted under the 2005 Directors Plan are not intended to qualify as incentive stock options within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the Code ). See Federal Income Tax Information for a discussion of the tax treatment of stock awards.

### **Purpose**

Our board adopted the 2005 Directors' Plan to provide a means to secure and retain the services of non-employee directors eligible to receive stock awards, to provide incentives for such individuals to exert maximum efforts for the success of Hollis-Eden and its affiliates, and to provide a means by which such eligible individuals may be given an opportunity to benefit from increases in the value of Hollis-Eden's common stock through the grant of stock awards.

### **Administration**

Our board administers the 2005 Directors' Plan. Subject to the provisions of the 2005 Directors' Plan, our board has the authority to construe and interpret the 2005 Directors' Plan, to determine the persons to whom and the dates on which stock awards will be granted, the number of shares of common stock to be subject to each stock award, the time or times during the term of each stock award within which all or a portion of the award may be exercised, the exercise, purchase, or strike price of each stock award, the type of consideration permitted to exercise or purchase each stock award, and other terms of the stock awards.

Our board has the authority to delegate some or all of the administration of the 2005 Directors' Plan to a committee or committees. Our board has delegated such administration to the Compensation Committee of our board. In the discretion of our board, a committee may consist solely of two or more non-employee directors within the meaning of Rule 16b-3 of the Securities Exchange Act of 1934, as amended. If administration is delegated to a committee, the committee has the authority to delegate certain administrative powers to a subcommittee of one or more members. As used herein with respect to the 2005 Directors' Plan, our board refers to any committee our board appoints or, if applicable, any subcommittee, as well as to our board itself.

### **Eligibility**

Only non-employee directors of Hollis-Eden are eligible to receive stock awards under the 2005 Directors' Plan.

### **Stock Subject to the 2005 Directors' Plan**

Subject to stockholder approval of this proposal, a maximum of 300,000 shares of common stock are available for issuance under the 2005 Directors' Plan, which includes 150,000 shares, previously reserved for issuance under the 2005 Directors' Plan, plus an additional 150,000 shares. If a stock award granted under the 2005 Directors' Plan expires or otherwise terminates without being exercised in full, or if any shares of common stock issued pursuant to a stock award are forfeited to or repurchased by Hollis-Eden, including, but not limited to, any repurchase or forfeiture caused by the failure to meet a contingency or condition required for the vesting of such shares, then the shares of common stock not issued under such stock award, or forfeited to or repurchased by Hollis-Eden shall revert to and again become available for issuance under the 2005 Directors' Plan. If any shares subject to a stock award are not delivered to a participant because such shares are withheld for the payment of taxes or the stock award is exercised through a reduction of shares subject to the stock award (i.e., net exercised), the number of shares that are not delivered shall remain available for issuance under the 2005 Directors' Plan. If the exercise price of any stock award is satisfied by tendering shares of common stock held by the participant, then the number of shares so tendered shall remain available for issuance under the 2005 Directors' Plan.

As of April 13, 2006, the closing price of our common stock as reported on the Nasdaq National Market was \$5.68 per share.

## Terms of Options

Options may be granted under the 2005 Directors' Plan pursuant to stock option agreements. The following is a description of the permissible terms of options under the 2005 Directors' Plan. Individual stock option agreements may be more restrictive as to any or all of the permissible terms described below.

*Exercise Price.* The exercise price of nonstatutory stock options may not be less than 100% of the fair market value of the stock on the date of grant.

*Consideration.* The exercise price of options granted under the 2005 Directors' Plan must be paid, to the extent permitted by applicable law and at the discretion of our board, (i) by cash or check, (ii) pursuant to a broker-assisted cashless exercise, (iii) by delivery of other common stock of Hollis-Eden, (iv) pursuant to a net exercise arrangement, or (v) in any other form of legal consideration acceptable to our board.

*Vesting.* Options granted under the 2005 Directors' Plan may become exercisable in cumulative increments, or vest, as determined by our board. Vesting typically will occur during the optionholder's continued service with Hollis-Eden or an affiliate, whether such service is performed in the capacity of an employee, consultant or director (collectively, "service") and regardless of any change in the capacity of the service performed. Shares covered by different options granted under the 2005 Directors' Plan may be subject to different vesting terms. The Board has the authority to accelerate the time during which an option may vest or be exercised. In addition, options granted under the 2005 Directors' Plan may permit exercise prior to vesting. However, any unvested shares acquired under such an early exercise arrangement will be subject to repurchase by Hollis-Eden, should the participant's service terminate before vesting.

*Tax Withholding.* To the extent provided by the terms of a stock option agreement, a participant may satisfy any federal, state or local tax withholding obligation relating to the exercise of the option by a cash payment upon exercise, by authorizing Hollis-Eden to withhold a portion of the stock otherwise issuable to the participant, by delivering already-owned common stock of Hollis-Eden, or by a combination of these means.

*Term.* The maximum term of options granted under the 2005 Directors' Plan is 10 years.

*Termination of Service.* Options granted under the 2005 Directors' Plan generally terminate three months after termination of the participant's service unless (i) termination is due to the participant's disability, in which case the option may be exercised (to the extent the option was exercisable at the time of the termination of service) at any time within 12 months following termination; (ii) the participant dies before the participant's service has terminated, or within generally three months after termination of service, in which case the option may be exercised (to the extent the option was exercisable at the time of the participant's death) within 18 months following the participant's death by the person or persons to whom the rights to such option have passed; or (iii) the option by its terms specifically provides otherwise. Under the 2005 Directors' Plan, the option term may be extended in the event that exercise of the option following termination of service is prohibited by applicable securities laws. In no event, however, may an option be exercised beyond the expiration of its term.

*Restrictions on Transfer.* Unless provided otherwise by our board, a participant in the 2005 Directors' Plan may not transfer an option other than by will or by the laws of descent and distribution or pursuant to a domestic relations order and during the lifetime of the participant, only the participant (or the transferee pursuant to a domestic relations order) may exercise an option. A participant may also designate a beneficiary who may exercise an option following the participant's death.

## Terms of Stock Appreciation Rights

Stock appreciation rights may be granted under the 2005 Directors' Plan pursuant to stock appreciation rights agreements.

*Exercise.* Each stock appreciation right is denominated in shares of common stock equivalents. Upon exercise of a stock appreciation right, Hollis-Eden will pay the participant an amount equal to the excess of



(i) the aggregate fair market value of Hollis-Eden's common stock on the date of exercise, over (ii) the strike price determined by our board on the date of grant.

*Settlement of Awards.* The appreciation distribution upon exercise of a stock appreciation right may be paid in cash, shares of Hollis-Eden's common stock, or any other form of consideration determined by our board.

*Vesting.* Stock appreciation rights vest and become exercisable at the rate specified in the stock appreciation right agreement as determined by our board.

*Termination of Service.* Upon termination of a participant's service, the participant generally may exercise any vested stock appreciation right for three months (or such longer or shorter period specified in the stock appreciation right agreement) after the date such service relationship ends. In no event may a stock appreciation right be exercised beyond the expiration of its term.

#### **Terms of Stock Purchase Awards and Restricted Stock Awards**

Stock purchase awards and restricted stock awards may be granted under the 2005 Directors' Plan pursuant to stock purchase award agreements and restricted stock award agreements, respectively.

*Purchase Price.* The purchase price for stock purchase awards must be at least the par value of Hollis-Eden's common stock.

*Consideration.* The purchase price for stock purchase awards may be payable either (i) in cash or by check, (ii) by past service rendered to Hollis-Eden, or (iii) in any other form of legal consideration acceptable to our board. Our board may grant restricted stock awards in consideration for past services rendered to Hollis-Eden or in exchange for any other form of legal consideration acceptable to our board, without the payment of a purchase price.

*Vesting.* Shares of stock acquired under a stock purchase or restricted stock award may, but need not, be subject to a repurchase option in favor of Hollis-Eden or forfeiture to Hollis-Eden in accordance with a vesting schedule as determined by our board. The Board has the authority to accelerate the vesting of stock acquired pursuant to a stock purchase or restricted stock award.

*Termination of Service.* Upon termination of a participant's service, Hollis-Eden may repurchase or otherwise reacquire any forfeited shares of stock that have not vested as of such termination under the terms of the applicable stock purchase award or restricted stock award agreement.

*Restrictions on Transfer.* Rights to acquire shares under a stock purchase or restricted stock award may be transferred only upon such terms and conditions as determined by our board.

#### **Terms of Restricted Stock Unit Awards**

Restricted stock unit awards may be granted under the 2005 Directors' Plan pursuant to restricted stock unit award agreements.

*Consideration.* The purchase price, if any, for restricted stock unit awards may be paid in any form of legal consideration acceptable to our board.

*Settlement of Awards.* A restricted stock unit award may be settled by the delivery of shares of Hollis-Eden's common stock, in cash, or by any combination of these means as determined by our board.

*Vesting.* Restricted stock unit awards vest at the rate specified in the restricted stock unit award agreement as determined by our board. However, at the time of grant, our board may impose additional restrictions or conditions that delay the delivery of stock or cash subject to the restricted stock unit award after vesting.

*Dividend Equivalents.* Dividend equivalent rights may be credited with respect to shares covered by a restricted stock unit award. Hollis-Eden does not anticipate paying cash dividends on its common stock for the foreseeable future, however.

*Termination of Service.* Except as otherwise provided in the applicable award agreement, restricted stock units that have not vested will be forfeited upon the participant's termination of service.

### **Terms of Other Equity Awards**

The Board may grant other equity awards that are valued in whole or in part by reference to Hollis-Eden's common stock. Subject to the provisions of the 2005 Directors' Plan, our board has the authority to determine the persons to whom and the dates on which such other equity awards will be granted, the number of shares of common stock (or cash equivalents) to be subject to each award, and other terms and conditions of such awards.

### **Changes to Capital Structure**

If any change is made to the outstanding shares of Hollis-Eden's common stock without Hollis-Eden's receipt of consideration (whether through a stock split or other specified change in the capital structure of Hollis-Eden), appropriate adjustments will be made to: (i) the maximum number and/or class of securities issuable under the 2005 Directors' Plan, and (ii) the number and/or class of securities and the price per share in effect under each outstanding stock award under the 2005 Directors' Plan.

### **Corporate Transactions; Changes in Control**

Under the 2005 Directors' Plan, unless otherwise provided in a written agreement between Hollis-Eden or any affiliate and the holder of the stock award, in the event of a corporate transaction (as defined in the 2005 Directors' Plan), all outstanding stock awards under the 2005 Directors' Plan may be assumed, continued or substituted for by any surviving or acquiring entity (or its parent company). If the surviving or acquiring entity (or its parent company) elects not to assume, continue or substitute for such stock awards, then (i) with respect to any such stock awards that are held by individuals whose continuous service with Hollis-Eden or its affiliates has not terminated prior to the effective date of the corporate transaction, the vesting and exercisability provisions of such stock awards will be accelerated in full and such awards will terminate if not exercised prior to the effective date of the corporate transaction, and (ii) with respect to any stock awards that are held by individuals whose continuous service with Hollis-Eden or its affiliates has terminated prior to the effective date of the corporate transaction, the vesting and exercisability provisions of such stock awards will not be accelerated and such awards will terminate if not exercised prior to the effective date of the corporate transaction (except that any reacquisition or repurchase rights held by Hollis-Eden with respect to such stock awards shall not terminate and may continue to be exercised notwithstanding the corporate transaction). In the event a stock award will terminate if not exercised, our board may provide, in its sole discretion, that the holder of such stock award may not exercise such stock award but will receive a payment equal to the excess of the value of the property the holder would have received upon exercise over any exercise price.

Other stock awards, such as stock purchase awards, may have their repurchase or forfeiture rights assigned to the surviving or acquiring entity (or its parent company) in the corporate transaction. If such repurchase or forfeiture rights are not assigned, then such stock awards will become fully vested.

In addition, each stock award under the 2005 Directors' Plan will immediately vest as to all of the shares subject to the stock award upon the occurrence of certain specified change in control transactions, whether or not such stock award is assumed, continued, or substituted by a surviving or acquiring entity in the transaction.

### **Duration, Termination and Amendment**

Our board may suspend or terminate the 2005 Directors' Plan without stockholder approval or ratification at any time. No stock awards may be granted under the 2005 Directors' Plan while the 2005 Directors' Plan is suspended or after it is terminated.

Our board may amend or modify the 2005 Directors' Plan at any time. However, no amendment shall be effective unless approved by the stockholders of Hollis-Eden to the extent stockholder approval is necessary to satisfy applicable law.

### **Federal Income Tax Information**

The following is a summary of the principal United States federal income taxation consequences to employees and Hollis-Eden with respect to participation in the 2005 Directors' Plan. This summary is not intended to be exhaustive, and does not discuss the income tax laws of any city, state or foreign jurisdiction in which a participant may reside.

*Nonstatutory Stock Options.* No taxable income is recognized by a participant upon the grant of a nonstatutory stock option. Upon exercise of a nonstatutory stock option, the participant will recognize ordinary income equal to the excess, if any, of the fair market value of the purchased shares on the exercise date over the exercise price paid for those shares. Generally, Hollis-Eden will be entitled (subject to the requirement of reasonableness and the satisfaction of a tax reporting obligation) to a corresponding income tax deduction in the tax year in which such ordinary income is recognized by the participant.

However, if the shares acquired upon exercise of the nonstatutory stock option are unvested and subject to repurchase by Hollis-Eden in the event of the participant's termination of service prior to vesting in those shares, the participant will not recognize any taxable income at the time of exercise, but will have to report as ordinary income, as and when Hollis-Eden's repurchase right lapses, an amount equal to the excess of (i) the fair market value of the shares on the date the repurchase right lapses, over (ii) the exercise price paid for the shares. The participant may, however, elect under Section 83(b) of the Code to include as ordinary income in the year of exercise of the option an amount equal to the excess of (i) the fair market value of the purchased shares on the exercise date, over (ii) the exercise price paid for such shares. If the Section 83(b) election is made, the participant will not recognize any additional income as and when the repurchase right lapses.

Upon disposition of the stock, the participant will recognize a capital gain or loss equal to the difference between the selling price and the sum of the amount paid for such stock plus any amount recognized as ordinary income upon acquisition (or vesting) of the stock. Such gain or loss will be long-term or short-term depending on whether the stock was held for more than one year.

*Stock Appreciation Rights.* No taxable income is realized upon the receipt of a stock appreciation right. Upon exercise of the stock appreciation right, the fair market value of the shares (or cash in lieu of shares) received is recognized as ordinary income to the participant in the year of such exercise. Generally, with respect to employees, Hollis-Eden is required to withhold from the payment made on exercise of the stock appreciation right or from regular wages or supplemental wage payments an amount based on the ordinary income recognized. Subject to the requirement of reasonableness and the satisfaction of a reporting obligation, Hollis-Eden will be entitled to an income tax deduction equal to the amount of ordinary income recognized by the participant.

*Stock Purchase Awards and Restricted Stock Awards.* Upon receipt of a stock purchase or restricted stock award, the participant will recognize ordinary income equal to the excess, if any, of the fair market value of the shares on the date of issuance over the purchase price, if any, paid for those shares. Hollis-Eden will be entitled (subject to the requirement of reasonableness and the satisfaction of a tax reporting obligation) to a corresponding income tax deduction in the tax year in which such ordinary income is recognized by the participant.

However, if the shares issued upon the grant of a stock purchase or restricted stock award are unvested and subject to repurchase by Hollis-Eden in the event of the participant's termination of service prior to vesting in those shares, the participant will not recognize any taxable income at the time of issuance, but will have to report as ordinary income, as and when Hollis-Eden's repurchase right lapses, an amount equal to the excess of (i) the

fair market value of the shares on the date the repurchase right lapses, over (ii) the purchase price, if any, paid for the shares. The participant may, however, elect under Section 83(b) of the Code to include as ordinary income in the year of issuance an amount equal to the excess of (x) the fair market value of the shares on the date of issuance, over (y) the purchase price, if any, paid for such shares. If the Section 83(b) election is made, the participant will not recognize any additional income as and when the repurchase right lapses.

Upon disposition of the stock acquired upon the receipt of a stock purchase or restricted stock award, the participant will recognize a capital gain or loss equal to the difference between the selling price and the sum of the amount paid for such stock plus any amount recognized as ordinary income upon issuance (or vesting) of the stock. Such gain or loss will be long-term or short-term depending on whether the stock was held for more than one year.

*Restricted Stock Unit Awards.* No taxable income is recognized upon receipt of a restricted stock unit award. The participant will recognize ordinary income in the year in which the shares subject to that unit are actually issued to the participant in an amount equal to the fair market value of the shares on the date of issuance. The participant and Hollis-Eden will be required to satisfy certain tax withholding requirements applicable to such income. Subject to the requirement of reasonableness and the satisfaction of a tax reporting obligation, Hollis-Eden will be entitled to an income tax deduction equal to the amount of ordinary income recognized by the participant at the time the shares are issued. In general, the deduction will be allowed for the taxable year in which such ordinary income is recognized by the participant.

#### **New Plan Benefits**

The following table presents certain information with respect to options granted under the 2005 Directors Plan during the year ended December 31, 2005 to all non-employee directors as a group. The dollar value of these options cannot be determined because they depend on the market value of the underlying shares of common stock on the date of exercise.

#### **PLAN BENEFITS**

##### **2005 Directors Plan**

<b>Name and Position</b>	<b>Number of Shares Underlying Options Granted</b>
All non-employee directors as a group	30,000

**Proposal 4****RATIFICATION OF SELECTION OF OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Audit Committee of our board of directors has selected BDO Seidman, LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2006 and has further directed that management submit the selection of independent registered public accounting firm for ratification by our stockholders at the annual meeting. BDO Seidman, LLP has audited our financial statements since our inception. Representatives of BDO Seidman, LLP are expected to be present at the annual meeting, will have an opportunity to make a statement if they so desire and will be available to respond to appropriate questions.

Stockholder ratification of the selection of BDO Seidman, LLP as our independent registered public accounting firm is not required by our bylaws or otherwise. However, our board is submitting the selection of BDO Seidman, LLP to the stockholders for ratification as a matter of good corporate practice. If the stockholders fail to ratify the selection, the Audit Committee and our board will reconsider whether or not to retain that firm. Even if the selection is ratified, the Audit Committee in its discretion may direct the appointment of a different independent registered public accounting firm at any time during the year if they determine that such a change would be in the best interests of the Company and our stockholders.

The affirmative vote of the holders of a majority of the shares present in person or represented by proxy and entitled to vote at the annual meeting will be required to ratify the selection of BDO Seidman, LLP. Abstentions will be counted toward the tabulation of votes cast on proposals presented to the stockholders and will have the same effect as negative votes. Broker non-votes are counted towards a quorum, but are not counted for any purpose in determining whether this matter has been approved.

**INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FEES**

The following table shows the fees incurred for services rendered by BDO Seidman, LLP, our independent auditor in 2005 and 2004. All such services were preapproved by the Audit Committee in accordance with the preapproval policy described below.

	2005	2004
<b>Audit Fees</b>		
Annual financial statements and reviews of quarterly financial statements	\$ 243,425 <sup>(1)</sup>	\$ 273,880 <sup>(3)</sup>
Review of other documents filed with the SEC	12,648	15,247
Other Fees	24,947 <sup>(2)</sup>	19,939 <sup>(4)</sup>
<b>Subtotal Audit Fees</b>	<b>\$ 281,020</b>	<b>\$ 309,066</b>
Audit Related Fees	-0-	-0-
Tax Fees	6,500	6,500
<b>Total</b>	<b>\$ 287,520</b>	<b>\$ 315,566</b>

- (1) Approximately \$66,750 in audit and quarterly review fees and \$176,675 in the audit of internal controls over financial reporting paid to our independent registered public accounting firm. This number does not include \$164,782 incurred for consultants related to Sarbanes Oxley Act Section 404 compliance.
- (2) Comprised of out-of pocket expenses, administrative fees and board and audit committee meeting attendance.
- (3) Approximately \$50,000 in audit and quarterly review fees and \$223,880 in the audit of internal controls over financial reporting paid to our independent registered accounting firm. This number does not include \$250,280 incurred from Moss Adams, LLP related to Sarbanes Oxley Act Section 404 compliance.
- (4) Comprised of out-of pocket expenses and administrative fees.

**PRE-APPROVAL POLICIES**

The Audit Committee pre-approves all audit and permissible non-audit services provided by the independent registered public accounting firm. These services may include audit services, audit-related services, internal control services, tax services and other services. The Audit Committee has adopted a policy for the pre-approval of services provided by the independent registered public accounting firm, BDO Seidman, LLP. The policy generally pre-approves specified services in the defined categories of audit services, audit-related services and tax services up to specified amounts. Pre-approval may also be given as part of the Audit Committee's approval of the scope of the engagement of the independent registered public accounting firm or on an individual explicit case-by-case basis before the independent registered public accounting firm is engaged to provide each service.

During the year, circumstances may arise when it may become necessary to engage the independent registered public accounting firm for additional services not contemplated in the original pre-approval. In those instances, the Audit Committee requires specific pre-approval before engaging the independent registered public accounting firm. The Audit Committee has delegated pre-approval authority to the Chairman of the Audit Committee for those such instances. The Chairman must report on such approvals at the next scheduled Audit Committee meeting.

The Audit Committee has determined that the rendering of the non-audit services by BDO Seidman, LLP is compatible with maintaining the auditor's independence.

All fiscal year 2005 audit and non-audit services provided by the independent registered public accounting firm were pre-approved.

**THE BOARD OF DIRECTORS RECOMMENDS**

**A VOTE IN FAVOR OF PROPOSAL 4.**

**EXECUTIVE OFFICERS AND SENIOR MANAGEMENT**

The following table sets forth information regarding our Executive Officers and Senior Management.

<b>Name</b>	<b>Age</b>	<b>Position</b>
Richard B. Hollis	53	Chairman of the Board, President and Chief Executive Officer
Daniel D. Burgess	44	Chief Operating Officer and Chief Financial Officer
James M. Frincke, Ph.D.	55	Chief Scientific Officer
Steven A. Gordziel, Ph.D.	59	Vice President, Product Development
Jessie R. Groothuis M.D.	59	Vice President, Clinical Affairs
Eric J. Loumeau	43	Vice President, Corporate General Counsel
Robert L. Marsella	53	Senior Vice President, Business Development
Christopher L. Reading, Ph.D.	58	Executive Vice President, Scientific Development
Dwight R. Stickney, M.D.	63	Vice President, Medical Affairs
Robert W. Weber	55	Chief Accounting Officer and Vice President Controller

*Richard B. Hollis* founded Hollis-Eden in August 1994, and currently serves as our Chairman, President and Chief Executive Officer. Mr. Hollis has over 29 years experience in the health care industry, has a proven track record of launching and marketing important new medical products, and a distinguished career of managing the growth and operations of companies in a variety of senior management positions. Mr. Hollis began his career in product sales with Baxter Travenol (today Baxter International), where he specialized in launching and marketing parenteral, enteral and intravenous solutions to hospitals and nursing homes. Mr. Hollis next joined Imed Corporation, a world leader in drug delivery devices in the 1980s, where he rapidly advanced through numerous sales, marketing and managerial positions. When Imed was acquired by Warner Lambert (today part of Pfizer Inc.), Mr. Hollis was one of two Division Managers at Imed. After leaving Warner Lambert, Mr. Hollis joined Genentech, Inc. as Western Business Unit Manager as the Bay Area biotechnology revolution was unfolding. At Genentech, Mr. Hollis was instrumental in the launch of two blockbuster pharmaceutical products Protropin (human growth hormone) and Activase (tissue plasiminogen activator). Following those successful product launches, Mr. Hollis joined Instromedix, a manufacturer of cardiac monitoring devices, as General Manager and Vice President of Marketing and Sales, and subsequently was named Chief Operating Officer of Bioject Medical, a manufacturer of needleless drug delivery devices. In 1994 he acted on his vision of founding a new pharmaceutical company, Hollis-Eden, which he initially self-funded and successfully brought public in 1997. Mr. Hollis received his B.A. in Psychology from San Francisco State University after studying the humanities while attending St. Mary's College.

*Daniel D. Burgess* became Chief Operating Officer and Chief Financial Officer of Hollis-Eden in 1999. Mr. Burgess joined Hollis-Eden from Nanogen Inc., where he served as Vice President and Chief Financial Officer. Prior to joining Nanogen in 1998, Mr. Burgess spent ten years with Gensia Sicom, Inc. (acquired by Teva Pharmaceutical Industries Limited) and Gensia Automedics, Inc., a partially owned subsidiary of Gensia Sicom. He served as President and a director of Gensia Automedics, where he was responsible for all functional areas of this medical products company. In addition, he was Vice President and Chief Financial Officer of Gensia Sicom, where he was responsible for finance, investor relations, business development and other administrative functions. Prior to joining Gensia, Mr. Burgess held positions at Castle & Cooke, Inc. and Smith Barney, Harris Upham and Company. He received a degree in Economics from Stanford University and an M.B.A. from Harvard Business School. Mr. Burgess is a member of the Board of Directors of Santarus, Inc. and Metabasis Therapeutics, Inc.

*James M. Frincke, Ph.D.*, joined Hollis-Eden as Vice President, Research and Development in 1997, was promoted to Executive Vice President in 1999, and to Chief Scientific Officer in 2001. Dr. Frincke joined Hollis-Eden from Prolinx, Inc., where he served as Vice President, Therapeutics Research and Development from 1995 to 1997. During his 24 years in the biotechnology industry, Dr. Frincke has managed major development programs including drugs, biologicals, and cellular and gene therapy products aimed at the treatment of cancer, infectious diseases and organ transplantation. Since joining the biotechnology industry, Dr. Frincke has held vice president, research and development positions in top tier biotechnology companies

including Hybritech/Eli Lilly and SyStemix Inc. (acquired by Novartis). In various capacities, he has been responsible for all aspects of pharmaceutical development including early stage research programs, product evaluation, pharmacology, manufacturing, and the management of regulatory and clinical matters for lead product opportunities. Dr. Frincke has authored or co-authored more than 100 scientific articles, abstracts and regulatory filings. Dr. Frincke received his B.S. in Chemistry and his Ph.D. in Chemistry from the University of California, Davis. Dr. Frincke completed his postdoctoral work at the University of California, San Diego.

*Steven A. Gordziel, Ph.D.*, joined Hollis-Eden in 2004 as Vice President, Product Development. His 30-year career in the pharmaceutical industry has encompassed the full spectrum of product development and manufacturing disciplines with a wide range of compounds, product formulations and manufacturing processes. Prior to joining Hollis-Eden, Dr. Gordziel was Vice President of Pharmaceutical Development at Penwest Pharmaceutical Company. At Penwest, he managed a team of 30 members responsible for formulation development, analytical development and validation, stability evaluation, scale up and process development and preparation of clinical supplies for regulatory filings and clinical studies. Previously, Dr. Gordziel was Vice President, Development Research, for the Wallace Pharmaceuticals Division of Carter Wallace, Inc. With Carter Wallace for more than 20 years, Dr. Gordziel had the opportunity to build the company's product development capabilities and assume increasing management responsibility in all aspects of product development. During this time Dr. Gordziel was heavily involved in numerous Investigational New Drug (IND) and New Drug Application (NDA) submissions. Dr. Gordziel began his career at Ortho Pharmaceuticals and Wyeth Laboratories as a formulations scientist. He earned a B.S. in Pharmacy from the Philadelphia College of Pharmacy, and his Ph.D. in Pharmaceutical Chemistry from the University of Connecticut, Storrs.

*Jessie R. Groothuis, M.D.*, joined Hollis-Eden in 2004 as Vice President, Clinical Affairs. Before joining Hollis-Eden, Dr. Groothuis was Global Medical Director, Immunoscience Development at Abbott Laboratories, where she managed the global clinical trials and strategy for her division. Most recently at Abbott, Dr. Groothuis managed a 20-member team, oversaw large multi-site global clinical trials, and was responsible for the registration and launch of Synagis, a monoclonal antibody, in a number of international markets. Throughout her seven-year tenure with Abbott, she managed all phases of development for multiple drug candidates, and was lead investigator for four separate drugs in Abbott's pipeline. Prior to Abbott, Dr. Groothuis was Director of the *Neonatal High Risk Follow Up Clinic* and Professor of Pediatrics at the University of Colorado School of Medicine and The Children's Hospital, Department of Pediatrics. In this position she was lead clinical investigator on a number of large clinical trials in the area of immunology. Dr. Groothuis is board certified by the American Board of Pediatrics and the National Board of Medical Examiners. She received her B.S. from Stanford University, her M.D. from the University of Chicago and post-doctoral training at Vanderbilt University.

*Eric J. Loumeau* became Vice President, Corporate General Counsel in 1999. Mr. Loumeau joined Hollis-Eden from the law firm of Cooley Godward LLP, where he had primary responsibility for Hollis-Eden's account for the previous four years. As a partner at Cooley Godward, Mr. Loumeau represented a number of private and public companies in corporate and securities law matters. He joined the firm in 1995 from Skadden, Arps, Slate, Meagher and Flom, where he was an associate for four years. Mr. Loumeau attended Harvard Law School and the University of California, Berkeley, Boalt Hall School of Law, where he received a J.D. degree. He holds a B.S. degree in Business Administration with an emphasis in finance from Brigham Young University.

*Robert L. Marsella* became Vice President of Business Development and Marketing of Hollis-Eden in 1997, and was promoted to Senior Vice President of Business Development and Marketing in 2004. Mr. Marsella has more than 25 years of medical sales, marketing, and distribution experience. Prior to joining Hollis-Eden, Mr. Marsella acted as a distributor of various cardiac related hospital products for a number of years. In addition, he has also served as Regional Manager for Genentech and launched Activase, t-pa (a biopharmaceutical drug) in the Western United States. Prior to joining Genentech, Mr. Marsella marketed intravenous infusion pumps for Imed Corporation for four years. Mr. Marsella began his career as a field sales representative and soon after was promoted to regional sales manager for U.S. Surgical Corporation, Auto Suture division. Mr. Marsella received his B.A. degree from San Diego State University.



*Christopher L. Reading, Ph.D.*, became Vice President of Scientific Development in 1999 and was promoted to Executive Vice President, Scientific Development in 2002. Prior to joining Hollis-Eden, Dr. Reading was Vice President of Product and Process Development at Novartis Inc.-owned SyStemix Inc. During this time, he successfully filed three investigational new drug applications (INDs) in the areas of stem cell therapy technology and stem cell gene therapy for HIV/AIDS. Prior to joining SyStemix, Dr. Reading served on the faculty of the M.D. Anderson Cancer Center in Houston for nearly 13 years. His positions there included Associate and Assistant Professor of Medicine in the Departments of Hematology and Tumor Biology. During his career, Dr. Reading has given more than 25 national and international scientific presentations, published more than 50 peer-reviewed journal articles and 15 invited journal articles as well as written nearly 20 book chapters, and received numerous grants and contracts which supported his research activities. Dr. Reading has served on the National Science Foundation Advisory Committee for Small Business Innovative Research Grants (SBIR) as well as on the editorial boards of *Journal of Biological Response Modifiers* and *Molecular Biotherapy*. He holds a number of patents for his work with monoclonal antibodies and devices. Dr. Reading received his Ph.D. in Biochemistry at the University of California at Berkeley and completed postdoctoral study in tumor biology at The University of California at Irvine. He earned his B.A. in biology at the University of California at San Diego.

*Dwight R. Stickney, M.D.*, was appointed Vice President, Medical Affairs in 2003. He joined Hollis-Eden as Medical Director, Oncology in 2000. Dr. Stickney joined Hollis-Eden from the Radiation Oncology Division of Radiological Associates of Sacramento Medical Group, Inc., in Sacramento, California, where he served as an oncologist since 1993. While at Radiological Associates, he served as Chairman of the Radiation Oncology Division from 1997 to 1999 and was a member of the Radiation Study section of the National Institute of Health's Division of Research Grants from 1993 to 1997. He also served as the Director of Radiation Research for Scripps Clinic and Research Foundation in La Jolla, California. Dr. Stickney has taught in medical academia as Associate Professor of Radiation Medicine at Loma Linda University School of Medicine and has served as Director of the International Order of Forrester's Cancer Research Laboratory and on the board of directors of the California Division of the American Cancer Society. Earlier in his career, Dr. Stickney held positions with Burroughs Wellcome and the Centers for Disease Control, and academic teaching appointments at The University of California at Los Angeles and The University of California at Riverside. He has also served as a consultant for a number of biotechnology companies on the design and conduct of clinical trials. Dr. Stickney holds a Bachelor of Science in Microbiology, a Masters of Science in Immunology, and a M.D. from Ohio State University. In addition, he is certified as a Diplomat of the American Board of Internal Medicine and Hematology and a Diplomat of the American Board of Radiology, Therapeutic Radiology.

*Robert W. Weber* joined Hollis-Eden in 1996 and currently serves as Chief Accounting Officer and Vice President-Controller. Mr. Weber has over twenty-five years of experience in financial management. Mr. Weber has been employed at executive levels by multiple start-up companies and contributed to the success of several turnaround situations. He previously served as Vice President of Finance at Prometheus Products, a subsidiary of Sierra Semiconductor (now PMC Sierra), from 1994 to 1996, and Vice President Finance and Chief Financial Officer for Amercom, a personal computer telecommunications software publishing company, from 1993 to 1994. From February 1988 to August 1993, Mr. Weber served as Vice President Finance and Chief Financial Officer of Instromedix, a company that develops and markets medical devices and software. Mr. Weber brings a broad and expert knowledge of many aspects of financial management. In various capacities, he has been responsible for all aspects of finance and accounting including cost accounting, cash management, filings with the Securities and Exchange Commission, investor relations, private and venture financing, corporate legal matters, acquisitions/divestitures as well as information services and computer automation. Mr. Weber received a B.S. from GMI Institute of Technology (now Kettering University) and an M.B.A. from the Stanford Graduate School of Business.

## SECURITY OWNERSHIP OF

## CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information regarding the ownership of our common stock as of February 28, 2006 by: (i) each director and nominee for director; (ii) each of the executive officers named in the compensation table; (iii) all of our executive officers and directors as a group; and (iv) all those known to us to be beneficial owners of more than five percent of our common stock. Except as otherwise shown, the address of each stockholder listed is in care of Hollis-Eden at 4435 Eastgate Mall, Suite 400, San Diego, CA 92121.

Beneficial Owner	Beneficial Ownership <sup>(1)</sup>	
	Number of Shares	Percent of Total
Richard B. Hollis <sup>(2)</sup>	3,676,899	14.0%
Robert E. Petersen & Margaret M. Petersen as Trustees for the R. E. & M. Petersen Living Trust Dated 1/17/83 <sup>(3)</sup> 4520 Wilshire Blvd., 20 <sup>th</sup> Floor Los Angeles, CA 90048	1,386,508	5.6%
James M. Frincke <sup>(4)</sup>	564,601	2.2%
Daniel D. Burgess <sup>(5)</sup>	347,964	1.4%
Thomas Charles Merigan <sup>(6)</sup>	273,292	1.1%
Salvatore J. Zizza <sup>(7)</sup>	191,750	*
Christopher L. Reading <sup>(8)</sup>	188,501	*
Eric J. Loumeau <sup>(9)</sup>	156,957	*
J. Paul Bagley <sup>(10)</sup>	123,397	*
Brendan R. McDonnell <sup>(11)</sup>	59,792	*
Jerome M. Hauer <sup>(12)</sup>	24,444	*
Marc R. Sarni <sup>(13)</sup>	24,444	*
All executive officers and directors as a group (13 persons) <sup>(14)</sup>	6,182,195	21.8%

\* Less than one percent.

- (1) This table is based upon information supplied by officers, directors and principal stockholders and Schedules 13D and 13G filed with the Securities and Exchange Commission. Unless otherwise indicated in the footnotes to this table and subject to community property laws where applicable, we believe that each of the stockholders named in this table has sole voting and investment power with respect to the shares indicated as beneficially owned. Applicable percentages are based on 24,813,335 shares outstanding on February 28, 2006, adjusted as required by rules promulgated by the Securities and Exchange Commission.
- (2) Includes 1,386,400 shares subject to options which are presently exercisable or will become exercisable within 60 days of February 28, 2006 and 2,158 shares held under our 401(k) plan.
- (3) Includes 1,053,149 shares held in the R. E. & M. Petersen Living Trust Dated 1/17/83, and 333,359 shares held in the name of Petersen Properties of which R. E. & M. Petersen Living Trust owns 100% of the shares.
- (4) Includes 522,149 shares subject to options which are presently exercisable or will become exercisable within 60 days of February 28, 2006 and 4,553 shares held under our 401(k) plan in his name. Also includes 26,715 shares subject to options which are presently exercisable or will become exercisable within 60 days of February 28, 2006 and 2,184 shares held under our 401(k) plan in his spouse's name.
- (5) Includes 334,708 shares subject to options which are presently exercisable or will become exercisable within 60 days of February 28, 2006 and 4,256 shares held under our 401(k) plan.
- (6) Includes 273,292 shares subject to options which are presently exercisable or will become exercisable within 60 days of February 28, 2006.
- (7) Includes 58,750 shares subject to options which are presently exercisable or will become exercisable within 60 days of February 28, 2006. Also includes 3,000 shares held in trust in the name of his children, with respect to which Mr. Zizza disclaims beneficial ownership.
- (8) Includes 180,104 shares subject to options which are presently exercisable or will become exercisable within 60 days of February 28, 2006 and 4,647 shares held under our 401(k) plan.

- (9) Includes 148,354 shares subject to options which are presently exercisable or will become exercisable within 60 days of February 28, 2006 and 4,053 shares held under our 401(k) plan.
- (10) Includes 59,583 shares subject to options which are presently exercisable or will become exercisable within 60 days of February 28, 2006; 500 shares held indirectly through Stone Pine Funding Systems, L.L.C. of which Mr. Bagley is a member of the board of directors; and 834 shares held indirectly through LHIP Management Company L.L.C. of which Mr. Bagley is the manager.
- (11) Includes 59,792 shares subject to options which are presently exercisable or will become exercisable within 60 days of February 28, 2006.
- (12) Includes 24,444 shares subject to options which are presently exercisable or will become exercisable within 60 days of February 28, 2006.
- (13) Includes 24,444 shares subject to options which are presently exercisable or will become exercisable within 60 days of February 28, 2006.
- (14) Includes 3,606,645 shares subject to options which are presently exercisable or will become exercisable within 60 days of February 28, 2006 and 30,095 shares held under our 401(k) plan.

**SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE**

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires our directors and executive officers, and persons who own more than ten percent of a registered class of our equity securities, to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of common stock and other of our equity securities. Officers, directors and greater than ten percent stockholders are required by Securities and Exchange Commission regulation to furnish us with copies of all Section 16(a) forms they file.

To our knowledge, based solely on a review of the copies of such reports furnished to us and written representations that no other reports were required, during the fiscal year ended December 31, 2005, all Section 16(a) filing requirements applicable to our officers, directors and greater than ten percent beneficial owners were complied with, except that Messrs. McDonnell and Merigan reported on Form 4s filed in July 2005, stock options granted in June 2005.

**COMPENSATION OF DIRECTORS**

During 2005, non-employee members of our board of directors were compensated \$2,500 for attendance at each in-person board meeting. They also are eligible for reimbursement of their expenses incurred in connection with such attendance in accordance with Hollis-Eden policy.

We also grant discretionary stock options to non-employee members of our board of directors. During the 2005 fiscal year, our board granted options covering an aggregate of 30,000 shares of our common stock, at an exercise price per share of \$10.75, under the 2005 Directors Plan to two directors for their services as directors. The fair market value of such common stock on the date of grant was \$10.75 per share (based on the closing sale price reported on Nasdaq for the date of grant). In March 2006, our board deemed it appropriate to grant options covering an aggregate of 75,000 shares of our common stock, at an exercise price of \$6.19 per share, under the 2005 Directors Plan (40,000 shares) and the 2005 Equity Plan (35,000 shares) to the five independent directors of our board. In addition, in April 2006, our board deemed it appropriate to grant Mr. Zizza an additional stock option to purchase up to 30,000 shares of our common stock, at an exercise price of \$5.52 per share, under the 2005 Equity Plan in connection with his appointment as the Lead Independent Director in March 2006. The exercise prices for these options were equal to the fair market value of our common stock on the dates of the grants (based on the closing sale prices reported on Nasdaq for the dates of grant).

For 2006, each non-employee director will receive an annual retainer of \$10,000, a fee of \$2,500 per in-person board meeting attended, and a fee of \$1,000 per telephonic board or telephonic committee meeting attended. Also, directors who serve as committee chairmen for board committees will receive an additional annual retainer of \$2,500 per year.

## COMPENSATION OF EXECUTIVE OFFICERS

## SUMMARY OF COMPENSATION

The following table shows for the fiscal years ended December 31, 2005, 2004 and 2003, compensation awarded or paid to, or earned by, our Chief Executive Officer and our other four most highly compensated executive officers at December 31, 2005, who earned in excess of \$100,000 in salary and bonus during the last year (the Named Executive Officers ):

## SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Annual Compensation			Long-Term Compensation Awards Securities
		Salary (\$)	Bonus (\$)	Other Compensation(\$)	Underlying Options/ SARs(#)
Mr. Richard B. Hollis Chairman of the Board, President and Chief Executive Officer	2005	500,000	250,000	-0-	124,800
	2004	485,000	325,000	-0-	160,000
	2003	451,000	347,000	-0-	240,000
Mr. Daniel D. Burgess Chief Financial Officer and Chief Operating Officer	2005	322,000	40,000	-0-	39,000
	2004	307,000	52,000	-0-	50,000
	2003	285,000	58,000	-0-	50,000
Dr. James M. Frincke Chief Scientific Officer	2005	280,000	40,000	-0-	46,800
	2004	267,000	52,000	-0-	64,000
	2003	248,000	51,000	-0-	70,000
Mr. Eric J. Loumeau Vice President, Corporate General Counsel	2005	255,000	35,000	-0-	19,500
	2004	243,000	45,000	-0-	25,000
	2002	225,500	46,000	-0-	25,000
Dr. Christopher L. Reading, M.D. Executive Vice President, Scientific Development	2005	244,000	40,000	-0-	19,500
	2004	232,000	52,000	-0-	31,000
	2003	215,500	65,000	-0-	41,000

## STOCK OPTION GRANTS AND EXERCISES

We grant options to our executive officers under our 2005 Equity Plan. As of March 31, 2006, options to purchase a total of 4,940,666 shares were outstanding under the 2005 Equity Plan and options to purchase 382,253 shares remained available for grant thereunder. If Proposal 2 contained in this proxy statement is approved by our stockholders, 882,253 shares will remain available for grant under the 2005 Equity Plan, as amended.

The following tables show for the fiscal year ended December 31, 2005, certain information regarding options granted to, or exercised by, and held at year-end by, the Named Executive Officers:

## OPTION GRANTS IN LAST FISCAL YEAR

Name	Shares Underlying Options Granted(#)	% of Total Options Granted to Non-Officer Employees in Fiscal Year(%)	Exercise Price(\$/sh)	Expiration Date	Potential Realizable Value At Assumed Annual Rates of Stock Price Appreciation For Option Term (\$) <sup>(1)</sup>	
					5%	10%
Richard B. Hollis	124,800	124.2%	\$ 10.75	2/10/2015	177,216	1,077,024
Daniel D. Burgess	39,000	38.8%	\$ 10.75	2/10/2015	55,380	336,570
James M. Frincke	46,800	48.6%	\$ 10.75	2/10/2015	66,456	403,884
Eric J. Loumeau	19,500	19.4%	\$ 10.75	2/10/2015	27,690	168,285
Christopher L. Reading	19,500	19.4%	\$ 10.75	2/10/2015	27,690	168,285

- (1) The potential realizable value is calculated based on the term of the option at its time of grant (ten years). It is calculated assuming that the closing market price per share of \$7.47 on the date these options were granted appreciates at the indicated annual rate, compounded annually for the entire term of the option, and that the option is exercised and sold on the last day of its term for the appreciated stock price. The per share exercise price of these options of \$10.75 represents an approximately 44% premium over the closing market price per share of \$7.47 on the date these options were granted. These amounts represent certain assumed rates of appreciation only, in accordance with the rules of the Securities and Exchange Commission, and do not reflect our estimate or projection of future stock price performance. Actual gains, if any, are dependent on the actual future performance of our common stock and no gain to the optionee is possible unless the stock price increases over the option term which will benefit all stockholders.

## AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR

AND FISCAL YEAR-END OPTION VALUES<sup>(1)</sup>

Name	Number Of Securities Underlying Options As Of Fiscal Year-End (#) <sup>(2)</sup>		Value of In-the-Money Options As Of Fiscal Year-End (\$) <sup>(3)</sup>	
	Exercisable	Unexercisable	Exercisable	Unexercisable
Richard B. Hollis	1,350,001	281,466	\$ 518,000	\$ -0-
Daniel D. Burgess	323,333	80,667	-0-	-0-
James M. Frincke	507,333	100,133	-0-	-0-
Eric J. Loumeau	142,666	40,334	-0-	-0-
Christopher L. Reading	182,250	38,354	-0-	-0-

- (1) None of the Named Executive Officers exercised options during the 2005 fiscal year, with the exception of Mr. Loumeau, who exercised 1,500 options in 2005.
- (2) Includes both in-the-money and out-of-the-money options.
- (3) The fair market value of the underlying shares on the last day of the fiscal year (\$4.84) less the exercise or base price.

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**EMPLOYMENT, SEVERANCE AND CHANGE OF CONTROL AGREEMENTS**

We have entered an employment agreement with Mr. Hollis, our Chairman of the Board, President and Chief Executive Officer, which includes a minimum bonus based on a formula that takes into account our achievements. In addition, if Mr. Hollis' employment is terminated without cause, Mr. Hollis shall be entitled to the following: (i) base salary through the date of termination, (ii) annual base salary in effect at the time of termination times five, (iii) an amount equal to the prior calendar year's bonus awarded to Mr. Hollis times five, (iv) immediate vesting of all unvested stock options to purchase shares of our common stock held by Mr. Hollis, and the continuation of the exercise period of all stock options held by Mr. Hollis until the final expiration of the original terms of such stock options, and (v) continued receipt for three years of all employee benefit plans and programs in which Mr. Hollis and his family were entitled to participate immediately prior to the date of termination. The employment agreement further provides that if Mr. Hollis' employment is terminated within one year of the occurrence of a change in control of Hollis-Eden, upon execution by Mr. Hollis of a waiver and release of claims, the new company shall pay Mr. Hollis the same benefits described in (i) through (v) above. In addition, the agreement provides that Mr. Hollis has the right, in specified circumstances, to require us to nominate him and two of his designees for election to our board. If this provision is violated, Mr. Hollis will be entitled to the same benefits described in (i) through (v) above. To date, however, Mr. Hollis has not exercised this right.

We have entered into an employment agreement with Mr. Burgess, our Chief Operating Officer and Chief Financial Officer, which provides that if Mr. Burgess' employment is terminated without cause, he will receive one year's severance pay, with benefits in place throughout the severance period. Additionally, his stock options will continue to vest throughout the severance period, with 90 days beyond that to exercise. The agreement also provides that in the event that a third party acquires 50% or more of our voting stock or acquires substantially all of our assets or in the event of a change of control of Hollis-Eden (as now or in the future defined in the our option plan), all of Mr. Burgess' then unvested stock options shall automatically immediately become vested and fully exercisable.

We have entered into an employment agreement with Mr. Loumeau, our Vice President, Corporate General Counsel, providing that in the event that a third party acquires 50% or more of our voting stock or acquires substantially all of our assets or in the event of a change of control of Hollis-Eden (as now or in the future defined in the our option plan), all of Mr. Loumeau's then unvested stock options shall automatically immediately become vested and fully exercisable.

**REPORT OF THE COMPENSATION COMMITTEE OF OUR BOARD OF DIRECTORS ON EXECUTIVE COMPENSATION**

The following is a report of the Compensation Committee of our board of directors describing the compensation policies and rationale applicable to the compensation paid to our executive officers.

The Compensation Committee of our board of directors reviews and recommends to our board for approval, our executive compensation policies. The Compensation Committee is responsible for reviewing our salary and benefits structure at least annually to insure its competitiveness within our industry. During 2005, the Compensation Committee was composed of three outside directors, Messrs. McDonnell, Bagley and Sarni.

**COMPENSATION PHILOSOPHY**

Our philosophy in establishing its compensation policy for executive officers and other employees is to create a structure designed to attract and retain highly skilled individuals by establishing salaries, benefits, and incentive compensation which compare favorably with those for similar positions in other pharmaceutical and biotechnology companies, to integrate pay programs with our business objectives, to link individual executive

compensation with our performance, and to reward for creating shareholder value over the long term. Compensation for our executive officers consists of a base salary and potential annual performance bonuses, as well as long-term incentive compensation through stock options, restricted stock grants, and matching contributions by us into our executive officers' 401(k) accounts.

#### **BASE SALARY**

The base salary component of compensation is designed to compensate executive officers competitively at levels necessary to attract and retain qualified executives in the pharmaceutical and biotechnology industry. In order to evaluate our competitive position in the industry, the Compensation Committee reviewed and analyzed the compensation packages, including base salary levels, offered by other biotechnology and pharmaceutical companies. Competitive information was obtained by contracting with a consulting firm and from a survey prepared by a second consulting company (the Biotechnology Executive Compensation Survey 2005). As a general matter, the base salary for each executive officer is initially established through negotiation at the time the officer is hired taking into account such officer's qualifications, experience, prior salary and competitive salary information. Year-to-year adjustments to each executive officer's base salary are based upon individual performance for the year, changes in the general level of base salaries of persons in comparable positions within the industry, and the average merit salary increase for such year for all of our employees, as well as other factors the Compensation Committee judges to be pertinent during an assessment period. In making base salary decisions, the Compensation Committee exercises its judgment to determine the appropriate weight to be given to each of these factors. The Compensation Committee believes that its process for determining and adjusting the base salary of executive officers is consistent with sound personnel practices.

#### **PERFORMANCE-BASED ANNUAL INCENTIVE BONUS**

Cash bonus payments are discretionary unless otherwise required pursuant to an employment agreement. Bonus payments, if any, to executive officers, including the Chief Executive Officer, or payments above the required annual minimum, are based on two principal factors: corporate performance as compared to our short and long-term strategic, financial, and operational goals and objectives, and individual contribution and performance relative to corporate performance and individual goals and objectives.

Bonus payment recommendations for executive officers other than the Chief Executive Officer are initiated by the Chief Executive Officer and submitted to the Compensation Committee for review. Bonus payment recommendations for the Chief Executive Officer are initiated by the Compensation Committee.

#### **LONG-TERM INCENTIVES AWARDS**

To conserve our cash resources, we place special emphasis on equity-based incentives to attract, retain and motivate executive officers as well as other employees. The Compensation Committee provides our executive officers with long-term incentive compensation through grants of stock options and restricted stock generally under the 2005 Equity Plan. Our board believes that stock options provide our executive officers with the opportunity to purchase and maintain an equity interest in us and to share in the appreciation of the value of our common stock. Our board believes that stock options directly motivate an executive to maximize long-term stockholder value. The options also utilize vesting periods that encourage key executives to continue in their employment with us. Our board considers the grant of each option subjectively, considering factors such as the individual performance of the executive officer and the anticipated contribution of the executive officer to the attainment of our long-term strategic performance goals. Long-term incentives granted in prior years are also taken into consideration. Grants are made to all employees when hired based on salary level and position. All employees, including executive officers, are eligible for subsequent, discretionary grants, which are generally based on either individual or corporate performance.

**CHIEF EXECUTIVE OFFICER COMPENSATION**

The compensation of our Chief Executive Officer is reviewed annually on the same basis as discussed above for all executive officers. On January 1, 2006, Mr. Hollis' base salary was increased from \$500,000 to \$512,500. Mr. Hollis' base salary and bonus were established in part by comparing the base salaries and bonuses of chief executive officers at other biotechnology and pharmaceutical companies. Mr. Hollis' target bonus per the terms of his employment agreement is 100% of his base salary with a minimum of 50% and a maximum greater than 100% upon attaining performance targets.

**SECTION 162(M)**

Our board has considered the potential future effects of Section 162(m) of the Internal Revenue Code on the compensation paid to our executive officers. Section 162(m) disallows a tax deduction for any publicly-held corporation for individual compensation exceeding \$1.0 million in any taxable year for any of the executive officers named in the proxy statement, unless compensation is performance-based. We have adopted a policy that, where reasonably practicable, we will seek to qualify the variable compensation paid to its executive officers for an exemption from the deductibility limitations of Section 162(m).

In approving the amount and form of compensation for our executive officers, the Compensation Committee will continue to consider all elements of the cost to us of providing such compensation, including the potential impact of Section 162(m).

The information contained in this report shall not be deemed to be soliciting material or to be filed with the Securities and Exchange Commission nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933, as amended or the Securities Exchange Act of 1934, as amended except to the extent that we specifically incorporates it by reference into any such filing.

Respectfully submitted by:

COMPENSATION COMMITTEE

Brendan R. McDonnell, Chairman

J. Paul Bagley

Marc R. Sarni

**COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION**

As noted above, our Compensation Committee consists of Mr. Bagley, Mr. McDonnell and Mr. Sarni. No member of the Compensation Committee has a relationship that would constitute an interlocking relationship with executive officers or directors of another entity.



### Performance Measurement Comparison<sup>(1)</sup>

The following graph compares changes through December 31, 2005, in the cumulative total return on our common stock, a broad market index, namely the NASDAQ Stock Market U.S. Index (the "NASDAQ Index"), and an industry index, namely the NASDAQ Pharmaceuticals Stocks Index (the "Industry Index"). The Industry Index comprises all companies listed on the NASDAQ Stock Market under SIC 283. All values assume reinvestment of the full amount of all dividends as of December 31 of each year.

(1) This Section is not soliciting material, is not deemed filed with the SEC and is not to be incorporated by reference in any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date hereof and irrespective of any general incorporation language in any such filing.

### CERTAIN TRANSACTIONS

In May 1996, in accordance with anti-dilution privileges under a private financing that we conducted in March 1995, we issued Richard B. Hollis a warrant that presently represents a right to purchase 393,250 shares of our common stock at a price of \$11.02 per share. In May 2000, the warrant was amended, pursuant to which the expiration date of the warrant was extended from January 7, 2002, to January 7, 2006. This warrant expired, unexercised, on January 7, 2006.

In March 1999, we entered into a consulting agreement with Jacmar/Viking, L.L.C. William H. Tilley, who was one of our directors, is a principal of Jacmar/Viking. As consideration for such consulting services, we issued to Jacmar/Viking a warrant to purchase an aggregate of 500,000 shares of our common stock at an exercise price of \$20.50 per share. The warrant is not subject to any vesting provisions and had an original expiration date of March 2002. In March 2001, we entered into an amendment to the original consulting agreement and warrant, pursuant to which the expiration date for the warrant was extended to March 2003. In March 2003, we amended the warrant so that the warrant is now exercisable into an aggregate of 250,000 shares of our common stock at an exercise price of \$10.00 per share. We also amended the warrant and the consulting agreement to extend the expiration date of the warrant to the earlier to occur of March 2006 or thirty days after the consulting agreement is terminated. This warrant expired, unexercised, in March 2006.

In March 2002, we issued to Dr. Joseph Hollis, a consultant, a warrant to purchase 60,000 shares of our common stock at an exercise price of \$11.00 per share. This warrant expired on March 18, 2005. Dr. Hollis is the brother of Richard B. Hollis.

In March 1993, options to purchase a total of 125,000 shares of our common stock with an exercise price of \$2.25 per share were issued to Dr. Merigan for consulting services. In March 2003, the options expired and we issued new options to Dr. Merigan to purchase a total of 125,000 shares of our common stock with an exercise price below market of \$2.25. Dr. Merigan is one of our directors.

#### **HOUSEHOLDING OF PROXY MATERIALS**

The Securities and Exchange Commission has adopted rules that permit companies and intermediaries (e.g., brokers) to satisfy the delivery requirements for proxy statements and annual reports with respect to two or more stockholders sharing the same address by delivering a single proxy statement addressed to those stockholders. This process, which is commonly referred to as householding, potentially means extra convenience for stockholders and cost savings for companies.

This year, a number of brokers with account holders who are our stockholders will be householding our proxy materials. A single proxy statement will be delivered to multiple stockholders sharing an address unless contrary instructions have been received from the affected stockholders. Once you have received notice from your broker that they will be householding communications to your address, householding will continue until you are notified otherwise or until you revoke your consent. If, at any time, you no longer wish to participate in householding and would prefer to receive a separate proxy statement and annual report, please notify your broker. Stockholders wishing to receive a separate proxy statement and annual report in the future may also direct such a request to our Secretary, either in a written request sent to 4435 Eastgate Mall, Suite 400, San Diego, California 92121 or by telephone at (858) 587-9333.

Stockholders who currently receive multiple copies of the proxy statement at their address and would like to request householding of their communications should contact their broker.

#### **OTHER MATTERS**

Our board of directors knows of no other matters that will be presented for consideration at the annual meeting. If any other matters are properly brought before the meeting, it is the intention of the persons named in the accompanying proxy to vote on such matters in accordance with their best judgment.

By Order of the Board of Directors  
RICHARD B. HOLLIS  
Chairman of the Board, President and  
Chief Executive Officer

April 27, 2006

**A COPY OF OUR ANNUAL REPORT TO THE SECURITIES AND EXCHANGE COMMISSION ON FORM 10-K FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005 IS AVAILABLE WITHOUT CHARGE UPON WRITTEN REQUEST TO: CORPORATE SECRETARY, HOLLIS-EDEN PHARMACEUTICALS, INC., 4435 EASTGATE MALL, SUITE 400, SAN DIEGO, CALIFORNIA 92121.**

## HOLLIS-EDEN PHARMACEUTICALS, INC.

## 2005 EQUITY INCENTIVE PLAN

AS AMENDED ON MARCH 18, 2006

**1. GENERAL.**

(a) **Successor and Continuation of Prior Plan.** The Plan is intended as the successor to and continuation of the Hollis-Eden Pharmaceuticals, Inc. 1997 Incentive Stock Option Plan (the *Prior Plan*). Following the Effective Date of this Plan, no additional stock awards shall be granted under the Prior Plan. Any shares remaining available for issuance pursuant to the exercise of options or settlement of stock awards under the Prior Plan shall be added to the share reserve of this Plan and available for issuance pursuant to Stock Awards granted hereunder. All outstanding stock awards granted under the Prior Plan shall remain subject to the terms of the Prior Plan, except that the Board may elect to extend one or more of the features of the Plan to stock awards granted under the Prior Plan. Any shares subject to outstanding stock awards granted under the Prior Plan that expire or terminate for any reason prior to exercise or settlement shall be added to the share reserve of this Plan and become available for issuance pursuant to Stock Awards granted hereunder. All Stock Awards granted subsequent to the Effective Date of this Plan shall be subject to the terms of this Plan.

(b) **Eligible Stock Award Recipients.** The persons eligible to receive Stock Awards are Employees, Directors and Consultants.

(c) **Available Stock Awards.** The Plan provides for the grant of the following Stock Awards: (i) Incentive Stock Options, (ii) Nonstatutory Stock Options, (iii) Stock Purchase Awards, (iv) Restricted Stock Awards, (v) Stock Appreciation Rights, (vi) Restricted Stock Unit Awards, and (vii) Other Stock Awards.

(d) **General Purpose.** The Company, by means of the Plan, seeks to secure and retain the services of the group of persons eligible to receive Stock Awards as set forth in Section 1(a), to provide incentives for such persons to exert maximum efforts for the success of the Company and any Affiliate and to provide a means by which such eligible recipients may be given an opportunity to benefit from increases in value of the Common Stock through the granting of Stock Awards.

**2. DEFINITIONS.**

As used in the Plan, the following definitions shall apply to the capitalized terms indicated below:

(a) **Affiliate** means (i) any corporation (other than the Company) in an unbroken ownership chain of corporations ending with the Company, provided each corporation in the unbroken ownership chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such ownership chain, and (ii) any corporation (other than the Company) in an unbroken ownership chain of corporations beginning with the Company, provided each corporation (other than the last corporation) in the unbroken ownership chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such ownership chain. The Board shall have the authority to determine (x) the time or times at which the ownership tests are applied, and (y) whether *Affiliate* includes entities other than corporations within the foregoing definition.

(b) **Board** means the Board of Directors of the Company.

(c) **Capitalization Adjustment** has the meaning ascribed to that term in Section 11(a).

(d) **Cause** means with respect to a Participant, the occurrence of any of the following: (i) such Participant's commission of any felony or any crime involving fraud, dishonesty or moral turpitude under the

laws of the United States or any state thereof; (ii) such Participant's attempted commission of, or participation in, a fraud or act of dishonesty against the Company; (iii) such Participant's intentional, material violation of any contract or agreement between the Participant and the Company or of any statutory duty owed to the Company; (iv) such Participant's unauthorized use or disclosure of the Company's confidential information or trade secrets; or (v) such Participant's gross misconduct. The determination that a termination of the Participant's Continuous Service is either for Cause or without Cause shall be made by the Company in its sole discretion. Any determination by the Company that the Continuous Service of a Participant was terminated by reason of dismissal without Cause for the purposes of outstanding Stock Awards held by such Participant shall have no effect upon any determination of the rights or obligations of the Company or such Participant for any other purpose.

**(e) *Change in Control*** means the occurrence, in a single transaction or in a series of related transactions, of any one or more of the following events:

**(i)** any Exchange Act Person becomes the Owner, directly or indirectly, of securities of the Company representing forty percent (40%) or more of the combined voting power of the Company's then outstanding securities other than by virtue of a merger, consolidation or similar transaction. Notwithstanding the foregoing, a Change in Control shall not be deemed to occur (A) on account of the acquisition of securities of the Company by an investor, any affiliate thereof or any other Exchange Act Person from the Company in a transaction or series of related transactions the primary purpose of which is to obtain financing for the Company through the issuance of equity securities or (B) solely because the level of Ownership held by any Exchange Act Person (the ***Subject Person***) exceeds the designated percentage threshold of the outstanding voting securities as a result of a repurchase or other acquisition of voting securities by the Company reducing the number of shares outstanding, provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of voting securities by the Company, and after such share acquisition, the Subject Person becomes the Owner of any additional voting securities that, assuming the repurchase or other acquisition had not occurred, increases the percentage of the then outstanding voting securities Owned by the Subject Person over the designated percentage threshold, then a Change in Control shall be deemed to occur;

**(ii)** there is consummated a merger, consolidation or similar transaction involving (directly or indirectly) the Company and, immediately after the consummation of such merger, consolidation or similar transaction, the stockholders of the Company immediately prior thereto, as such, do not Own, directly or indirectly, either (A) outstanding voting securities representing more than sixty percent (60%) of the combined outstanding voting power of the surviving Entity in such merger, consolidation or similar transaction or (B) more than sixty percent (60%) of the combined outstanding voting power of the parent of the surviving Entity in such merger, consolidation or similar transaction, in each case in substantially the same proportions as their Ownership of the outstanding voting securities of the Company immediately prior to such transaction;

**(iii)** the stockholders of the Company approve or the Board approves a plan of complete dissolution or liquidation of the Company, or a complete dissolution or liquidation of the Company shall otherwise occur;

**(iv)** there is consummated a sale, lease, exclusive license or other disposition of all or substantially all of the consolidated assets of the Company and its Subsidiaries, other than a sale, lease, license or other disposition of all or substantially all of the consolidated assets of the Company and its Subsidiaries to an Entity, more than fifty percent (50%) of the combined voting power of the voting securities of which are Owned by stockholders of the Company in substantially the same proportions as their Ownership of the outstanding voting securities of the Company immediately prior to such sale, lease, license or other disposition; or

**(v)** individuals who, on the date this Plan is adopted by the Board, are members of the Board (the ***Incumbent Board***) cease for any reason to constitute at least a majority of the members of the Board; *provided, however*, that if the appointment or election (or nomination for election) of any new Board

member was approved or recommended by a majority vote of the members of the Incumbent Board then still in office, such new member shall, for purposes of this Plan, be considered as a member of the Incumbent Board.

The term Change in Control shall not include a sale of assets, merger or other transaction effected exclusively for the purpose of changing the domicile of the Company.

Notwithstanding the foregoing or any other provision of this Plan, the definition of Change in Control (or any analogous term) in an individual written agreement between the Company or any Affiliate and the Participant shall supersede the foregoing definition with respect to Stock Awards subject to such agreement; *provided, however*, that if no definition of Change in Control or any analogous term is set forth in such an individual written agreement, the foregoing definition shall apply.

(f) **Code** means the Internal Revenue Code of 1986, as amended.

(g) **Committee** means a committee of one (1) or more Directors to whom authority has been delegated by the Board in accordance with Section 3(c).

(h) **Common Stock** means the common stock of the Company.

(i) **Company** means Hollis-Eden Pharmaceuticals, Inc., a Delaware corporation.

(j) **Consultant** means any person, including an advisor, who is (i) engaged by the Company or an Affiliate to render consulting or advisory services and is compensated for such services, or (ii) serving as a member of the board of directors of an Affiliate and is compensated for such services. However, service solely as a Director, or payment of a fee for such service, shall not cause a Director to be considered a Consultant for purposes of the Plan.

(k) **Continuous Service** means that the Participant's service with the Company or an Affiliate, whether as an Employee, Director or Consultant, is not interrupted or terminated. A change in the capacity in which the Participant renders service to the Company or an Affiliate as an Employee, Consultant or Director or a change in the entity for which the Participant renders such service, provided that there is no interruption or termination of the Participant's service with the Company or an Affiliate, shall not terminate a Participant's Continuous Service. For example, a change in status from an employee of the Company to a consultant to an Affiliate or to a Director shall not constitute an interruption of Continuous Service. To the extent permitted by law, the Board or the chief executive officer of the Company, in that party's sole discretion, may determine whether Continuous Service shall be considered interrupted in the case of any leave of absence approved by that party, including sick leave, military leave or any other personal leave. Notwithstanding the foregoing, a leave of absence shall be treated as Continuous Service for purposes of vesting in a Stock Award only to such extent as may be provided in the Company's leave of absence policy, in the written terms of any leave of absence agreement or policy applicable to the Participant, or as otherwise required by law.

(l) **Corporate Transaction** means the occurrence, in a single transaction or in a series of related transactions, of any one or more of the following events:

(i) a sale or other disposition of all or substantially all, as determined by the Board in its sole discretion, of the consolidated assets of the Company and its Subsidiaries;

(ii) a sale or other disposition of at least ninety percent (90%) of the outstanding securities of the Company;

(iii) the consummation of a merger, consolidation or similar transaction following which the Company is not the surviving corporation; or

(iv) the consummation of a merger, consolidation or similar transaction following which the Company is the surviving corporation but the shares of Common Stock outstanding immediately preceding the

merger, consolidation or similar transaction are converted or exchanged by virtue of the merger, consolidation or similar transaction into other property, whether in the form of securities, cash or otherwise.

- (m) **Covered Employee** shall have the meaning provided in Section 162(m)(3) of the Code and the regulations promulgated thereunder.
- (n) **Director** means a member of the Board.
- (o) **Disability** means the permanent and total disability of a person within the meaning of Section 22(e)(3) of the Code.
- (p) **Effective Date** means the effective date of this Plan document, which is the date that this Plan is first approved by the Company's stockholders.
- (q) **Employee** means any person employed by the Company or an Affiliate. However, service solely as a Director, or payment of a fee for such services, shall not cause a Director to be considered an Employee for purposes of the Plan.
- (r) **Entity** means a corporation, partnership, limited liability company or other entity.
- (s) **Exchange Act** means the Securities Exchange Act of 1934, as amended.
- (t) **Exchange Act Person** means any natural person, Entity or group (within the meaning of Section 13(d) or 14(d) of the Exchange Act), except that Exchange Act Person shall not include (i) the Company or any Subsidiary of the Company, (ii) any employee benefit plan of the Company or any Subsidiary of the Company or any trustee or other fiduciary holding securities under an employee benefit plan of the Company or any Subsidiary of the Company, (iii) an underwriter temporarily holding securities pursuant to an offering of such securities, (iv) an Entity Owned, directly or indirectly, by the stockholders of the Company in substantially the same proportions as their Ownership of stock of the Company; or (v) any natural person, Entity or group (within the meaning of Section 13(d) or 14(d) of the Exchange Act) that, as of the Effective Date of the Plan as set forth in Section 13, is the Owner, directly or indirectly, of securities of the Company representing forty percent (40%) or more of the combined voting power of the Company's then outstanding securities.
- (u) **Fair Market Value** means, as of any date, the value of the Common Stock determined as follows:
- (i) If the Common Stock is listed on any established stock exchange or traded on the Nasdaq National Market or the Nasdaq SmallCap Market, the Fair Market Value of a share of Common Stock shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such exchange or market (or the exchange or market with the greatest volume of trading in the Common Stock) on the date of determination, as reported in *The Wall Street Journal* or such other source as the Board deems reliable. Unless otherwise provided by the Board, if there is no closing sales price (or closing bid if no sales were reported) for the Common Stock on the date of determination, then the Fair Market Value shall be the closing selling price (or closing bid if no sales were reported) on the last preceding date for which such quotation exists.
- (ii) In the absence of such markets for the Common Stock, the Fair Market Value shall be determined by the Board in good faith.
- (v) **Incentive Stock Option** means an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code and the regulations promulgated thereunder.
- (w) **Non-Employee Director** means a Director who either (i) is not a current employee or officer of the Company or an Affiliate, does not receive compensation, either directly or indirectly, from the Company or an

Affiliate for services rendered as a consultant or in any capacity other than as a Director (except for an amount as to which disclosure would not be required under Item 404(a) of Regulation S-K promulgated pursuant to the Securities Act ( *Regulation S-K* )), does not possess an interest in any other transaction for which disclosure would be required under Item 404(a) of Regulation S-K, and is not engaged in a business relationship for which disclosure would be required pursuant to Item 404(b) of Regulation S-K; or (ii) is otherwise considered a non-employee director for purposes of Rule 16b-3.

(x) *Nonstatutory Stock Option* means any Option other than an Incentive Stock Option.

(y) *Officer* means a person who is an officer of the Company within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder.

(z) *Option* means an Incentive Stock Option or a Nonstatutory Stock Option to purchase shares of Common Stock granted pursuant to the Plan.

(aa) *Option Agreement* means a written agreement between the Company and an Optionholder evidencing the terms and conditions of an Option grant. Each Option Agreement shall be subject to the terms and conditions of the Plan.

(bb) *Optionholder* means a person to whom an Option is granted pursuant to the Plan or, if permitted under the terms of this Plan, such other person who holds an outstanding Option.

(cc) *Other Stock Award* means an award based in whole or in part by reference to the Common Stock which is granted pursuant to the terms and conditions of Section 7(e).

(dd) *Other Stock Award Agreement* means a written agreement between the Company and a holder of an Other Stock Award evidencing the terms and conditions of an Other Stock Award grant. Each Other Stock Award Agreement shall be subject to the terms and conditions of the Plan.

(ee) *Outside Director* means a Director who either (i) is not a current employee of the Company or an affiliated corporation (within the meaning of Treasury Regulations promulgated under Section 162(m) of the Code), is not a former employee of the Company or an affiliated corporation who receives compensation for prior services (other than benefits under a tax-qualified retirement plan) during the taxable year, has not been an officer of the Company or an affiliated corporation, and does not receive remuneration from the Company or an affiliated corporation, either directly or indirectly, in any capacity other than as a Director, or (ii) is otherwise considered an outside director for purposes of Section 162(m) of the Code.

(ff) *Own, Owned, Owner, Ownership* A person or Entity shall be deemed to Own, to have Owned, to be the Owner of, or to have acquired Ownership of securities if such person or Entity, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares voting power, which includes the power to vote or to direct the voting, with respect to such securities.

(gg) *Participant* means a person to whom a Stock Award is granted pursuant to the Plan or, if applicable, such other person who holds an outstanding Stock Award.

(hh) *Performance Criteria* means the one or more criteria that the Board shall select for purposes of establishing the Performance Goals for a Performance Period. The Performance Criteria that shall be used to establish such Performance Goals may be based on any one of, or combination of, the following: (i) earnings per share; (ii) earnings before interest, taxes and depreciation; (iii) earnings before interest, taxes, depreciation and amortization; (iv) total stockholder return; (v) return on equity; (vi) return on assets, investment, or capital employed; (vii) operating margin; (viii) gross margin; (ix) operating income; (x) net income (before or after taxes); (xi) net operating income; (xii) net operating income after tax; (xiii) pre-tax profit; (xiv) operating cash

flow; (xv) sales or revenue targets; (xvi) increases in revenue or product revenue; (xvii) expenses and cost reduction goals; (xviii) improvement in or attainment of working capital levels; (xix) economic value added (or an equivalent metric); (xx) market share; (xxi) cash flow; (xxii) cash flow per share; (xxiii) share price performance; (xxiv) debt reduction; (xxv) implementation or completion of projects or processes; (xxvi) customer satisfaction; (xxvii); stockholders' equity; and (xxviii) other measures of performance selected by the Board. Partial achievement of the specified criteria may result in the payment or vesting corresponding to the degree of achievement as specified in the Stock Award Agreement. The Board shall, in its sole discretion, define the manner of calculating the Performance Criteria it selects to use for such Performance Period.

**(ii) Performance Goals** means, for a Performance Period, the one or more goals established by the Board for the Performance Period based upon the Performance Criteria. Performance Goals may be based on a Company-wide basis, with respect to one or more business units, divisions, Affiliates, or business segments, and in either absolute terms or relative to the performance of one or more comparable companies or a relevant index. At the time of the grant of any Stock Award, the Board is authorized to determine whether, when calculating the attainment of Performance Goals for a Performance Period: (i) to exclude restructuring and/or other nonrecurring charges; (ii) to exclude exchange rate effects, as applicable, for non-U.S. dollar denominated net sales and operating earnings; (iii) to exclude the effects of changes to generally accepted accounting standards required by the Financial Accounting Standards Board; (iv) to exclude the effects of any statutory adjustments to corporate tax rates; and (v) to exclude the effects of any extraordinary items as determined under generally accepted accounting principles. In addition, the Board retains the discretion to reduce or eliminate the compensation or economic benefit due upon attainment of Performance Goals.

**(jj) Performance Period** means the period of time selected by the Board over which the attainment of one or more Performance Goals will be measured for the purpose of determining a Participant's right to and the payment of a Stock Award. Performance Periods may be of varying and overlapping duration, at the sole discretion of the Board.

**(kk) Plan** means this Hollis-Eden Pharmaceuticals, Inc. 2005 Equity Incentive Plan.

**(ll) Restricted Stock Award** means an award of shares of Common Stock which is granted pursuant to the terms and conditions of Section 7(b).

**(mm) Restricted Stock Award Agreement** means a written agreement between the Company and a holder of a Restricted Stock Award evidencing the terms and conditions of a Restricted Stock Award grant. Each Restricted Stock Award Agreement shall be subject to the terms and conditions of the Plan.

**(nn) Restricted Stock Unit Award** means a right to receive shares of Common Stock which is granted pursuant to the terms and conditions of Section 7(c).

**(oo) Restricted Stock Unit Award Agreement** means a written agreement between the Company and a holder of a Restricted Stock Unit Award evidencing the terms and conditions of a Restricted Stock Unit Award grant. Each Restricted Stock Unit Award Agreement shall be subject to the terms and conditions of the Plan.

**(pp) Rule 16b-3** means Rule 16b-3 promulgated under the Exchange Act or any successor to Rule 16b-3, as in effect from time to time.

**(qq) Securities Act** means the Securities Act of 1933, as amended.

**(rr) Stock Appreciation Right** means a right to receive the appreciation on Common Stock that is granted pursuant to the terms and conditions of Section 7(d).

**(ss) Stock Appreciation Right Agreement** means a written agreement between the Company and a holder of a Stock Appreciation Right evidencing the terms and conditions of a Stock Appreciation Right grant. Each Stock Appreciation Right Agreement shall be subject to the terms and conditions of the Plan.



**(tt) Stock Award** means any right granted under the Plan, including an Incentive Stock Option, a Nonstatutory Stock Option, a Stock Purchase Award, a Restricted Stock Award, a Stock Appreciation Right, a Restricted Stock Unit Award, or any Other Stock Award.

**(uu) Stock Award Agreement** means a written agreement between the Company and a Participant evidencing the terms and conditions of a Stock Award grant. Each Stock Award Agreement shall be subject to the terms and conditions of the Plan.

**(vv) Stock Purchase Award** means an award of shares of Common Stock which is granted pursuant to the terms and conditions of Section 7(a).

**(ww) Stock Purchase Award Agreement** means a written agreement between the Company and a holder of a Stock Purchase Award evidencing the terms and conditions of a Stock Purchase Award grant. Each Stock Purchase Award Agreement shall be subject to the terms and conditions of the Plan.

**(xx) Subsidiary** means, with respect to the Company, (i) any corporation of which more than fifty percent (50%) of the outstanding capital stock having ordinary voting power to elect a majority of the board of directors of such corporation (irrespective of whether, at the time, stock of any other class or classes of such corporation shall have or might have voting power by reason of the happening of any contingency) is at the time, directly or indirectly, Owned by the Company, and (ii) any partnership in which the Company has a direct or indirect interest (whether in the form of voting or participation in profits or capital contribution) of more than fifty percent (50%).

**(yy) Ten Percent Stockholder** means a person who Owns (or is deemed to Own pursuant to Section 424(d) of the Code) stock possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or any Affiliate.

### **3. ADMINISTRATION.**

**(a) Administration by Board.** The Board shall administer the Plan unless and until the Board delegates administration of the Plan to a Committee or Committees, as provided in Section 3(c).

**(b) Powers of Board.** The Board shall have the power, subject to, and within the limitations of, the express provisions of the Plan:

**(i)** To determine from time to time (A) which of the persons eligible under the Plan shall be granted Awards; (B) when and how each Award shall be granted; (C) what type or combination of types of Award shall be granted; (D) the provisions of each Award granted (which need not be identical), including the time or times when a person shall be permitted to receive Common Stock pursuant to a Stock Award; and (E) the number of shares of Common Stock with respect to which a Stock Award shall be granted to each such person.

**(ii)** To construe and interpret the Plan and Awards granted under it, and to establish, amend and revoke rules and regulations for its administration. The Board, in the exercise of this power, may correct any defect, omission or inconsistency in the Plan or in any Stock Award Agreement, in a manner and to the extent it shall deem necessary or expedient to make the Plan or Award fully effective.

**(iii)** To settle all controversies regarding the Plan and Awards granted under it.

**(iv)** To accelerate the time at which a Stock Award may first be exercised or the time during which an Award or any part thereof will vest in accordance with the Plan, notwithstanding the provisions in the Award stating the time at which it may first be exercised or the time during which it will vest.

**(v)** To suspend or terminate the Plan at any time. Suspension or termination of the Plan shall not impair rights and obligations under any Stock Award granted while the Plan is in effect except with the written consent of the affected Participant.

- (vi) To amend the Plan, subject to the limitations, if any, of applicable law. However, except as provided in Section 11(a) relating to Capitalization Adjustments, no amendment shall be effective unless approved by the stockholders of the Company to the extent stockholder approval is necessary to satisfy applicable law or applicable exchange listing requirements. Rights under any Award granted before amendment of the Plan shall not be impaired by any amendment of the Plan unless (i) the Company requests the consent of the affected Participant, and (ii) such Participant consents in writing.
- (vii) To submit any amendment to the Plan for stockholder approval, including, but not limited to, amendments to the Plan intended to satisfy the requirements of Section 162(m) of the Code and the regulations thereunder regarding the exclusion of performance-based compensation from the limit on corporate deductibility of compensation paid to Covered Employees.
- (viii) To amend the Plan in any respect the Board deems necessary or advisable to provide eligible Employees with the maximum benefits provided or to be provided under the provisions of the Code and the regulations promulgated thereunder relating to Incentive Stock Options or to bring the Plan or Incentive Stock Options granted under it into compliance therewith.
- (ix) To amend the terms of any one or more Awards or stock awards granted under the Prior Plan, including, but not limited to, amendments to provide terms more favorable than previously provided in the Award Agreement, subject to any specified limits in the Plan that are not subject to Board discretion; *provided, however*, that the rights under any Award shall not be impaired by any such amendment unless (i) the Company requests the consent of the affected Participant, and (ii) such Participant consents in writing.
- (x) Generally, to exercise such powers and to perform such acts as the Board deems necessary or expedient to promote the best interests of the Company and that are not in conflict with the provisions of the Plan or Awards.
- (xi) To adopt such procedures and sub-plans as are necessary or appropriate to permit participation in the Plan by Employees, Directors or Consultants who are foreign nationals or employed outside the United States.

**(c) Delegation to Committee.**

**(i) General.** Except as otherwise provided in Section 5(e) herein, the Board may delegate some or all of the administration of the Plan to a Committee or Committees. If administration of the Plan is delegated to a Committee, the Committee shall have, in connection with the administration of the Plan, the powers theretofore possessed by the Board that have been delegated to the Committee, including the power to delegate to a subcommittee of the Committee any of the administrative powers the Committee is authorized to exercise (and references in this Plan to the Board shall thereafter be to the Committee or subcommittee), subject, however, to such resolutions, not inconsistent with the provisions of the Plan, as may be adopted from time to time by the Board. The Board may retain the authority to concurrently administer the Plan with the Committee and may, at any time, revest in the Board some or all of the powers previously delegated.

**(ii) Section 162(m) and Rule 16b-3 Compliance.** In the sole discretion of the Board, the Committee may consist solely of two or more Outside Directors, in accordance with Section 162(m) of the Code, or solely of two or more Non-Employee Directors, in accordance with Rule 16b-3. In addition, the Board or the Committee, in its sole discretion, may (A) delegate to a Committee of Directors who need not be Outside Directors the authority to grant Awards to eligible persons who are either (I) not then Covered Employees and are not expected to be Covered Employees at the time of recognition of income resulting from such Stock Award, or (II) not persons with respect to whom the Company wishes to comply with Section 162(m) of the Code, or (B) delegate to a Committee of Directors who need not be Non-Employee Directors the authority to grant Stock Awards to eligible persons who are not then subject to Section 16 of the Exchange Act.

**(d) Delegation to an Officer.** The Board may delegate to one or more Officers the authority to do one or both of the following (i) designate Employees who are not Officers to be recipients of Awards and the terms

thereof, and (ii) determine the number of shares of Common Stock to be subject to such Stock Awards granted to such Employees; *provided, however*, that the Board resolutions regarding such delegation shall specify the total number of shares of Common Stock that may be subject to the Stock Awards granted by such Officer and that such Officer may not grant a Stock Award to himself or herself. Notwithstanding anything to the contrary in this Section 3(d), (x) the Board may not delegate to an Officer authority to determine the Fair Market Value of the Common Stock pursuant to Section 2(u)(ii) above, and (y) Awards covering Inducement Shares (as defined in Section 5(e) herein) must be granted either by a majority of the Company's independent directors or a committee comprised of a majority of independent directors.

**(e) Effect of Board's Decision.** All determinations, interpretations and constructions made by the Board in good faith shall not be subject to review by any person and shall be final, binding and conclusive on all persons.

#### **4. SHARES SUBJECT TO THE PLAN.**

**(a) Share Reserve.** Subject to the provisions of Section 11(a) relating to Capitalization Adjustments, the number of shares of Common Stock that may be issued pursuant to Stock Awards shall not exceed, in the aggregate, the sum of (i) the number of shares remaining available for issuance under the Prior Plan as of the Effective Date, including shares subject to outstanding stock awards under the Prior Plan, (ii) an additional three hundred fifty thousand (350,000) shares approved by the stockholders at the 2005 Annual Meeting as part of the approval of this Plan, (iii) an additional five hundred thousand (500,000) shares approved by the stockholders at the 2006 Annual Meeting plus (iv) one hundred thousand (100,000) shares of Common Stock that are subject to the limitations contained in Section 5(e) hereof. Shares may be issued in connection with a merger or acquisition as permitted by NASD Rule 4350(i)(1)(A)(iii) or, if applicable, NYSE Listed Company Manual Section 303A(8) and such issuance shall not reduce the number of shares available for issuance under the Plan.

**(b) Reversion of Shares to the Share Reserve.** If any (i) Stock Award shall for any reason expire or otherwise terminate, in whole or in part, without having been exercised in full, (ii) shares of Common Stock issued to a Participant pursuant to a Stock Award (including the Stock Awards transferred from the Prior Plan on the Effective Date of this Plan) are forfeited to or repurchased by the Company, including any repurchase or forfeiture caused by the failure to meet a contingency or condition required for the vesting of such shares, or (iii) Stock Award is settled in cash, then the shares of Common Stock not issued under such Stock Award, or forfeited to or repurchased by the Company, shall revert to and again become available for issuance under the Plan. If any shares subject to a Stock Award are not delivered to a Participant because the Stock Award is exercised through a reduction of shares subject to the Stock Award (*i.e.*, net exercised), the number of shares that are not delivered to the Participant shall remain available for issuance under the Plan. If any shares subject to a Stock Award are not delivered to a Participant because such shares are withheld in satisfaction of the withholding of taxes incurred in connection with the exercise of an Option, Stock Appreciation Right, or the issuance of shares under a Stock Purchase Award, Restricted Stock Award, or Restricted Stock Unit Award, the number of shares that are not delivered to the Participant shall remain available for subsequent issuance under the Plan. If the exercise price of any Stock Award is satisfied by tendering shares of Common Stock held by the Participant (either by actual delivery or attestation), then the number of shares so tendered shall remain available for subsequent issuance under the Plan. Notwithstanding the foregoing, Inducement Shares (as defined in Section 5(e) herein) that revert to, or remain available for subsequent issuance under, the Plan may only be granted to the persons described in Section 5(e).

**(c) Incentive Stock Option Limit.** Notwithstanding anything to the contrary in this Section 4(b), subject to the provisions of Section 11(a) relating to Capitalization Adjustments the aggregate maximum number of shares of Common Stock that may be issued pursuant to the exercise of Incentive Stock Options shall be six million (6,000,000) shares of Common Stock. Further, Inducement Shares (as defined in Section 5(e) herein) may not be used to grant Awards of Incentive Stock Options.

**(d) Source of Shares.** The stock issuable under the Plan shall be shares of authorized but unissued or reacquired Common Stock, including shares repurchased by the Company.

**5. ELIGIBILITY.**

**(a) Eligibility for Specific Stock Awards.** Incentive Stock Options may be granted only to Employees. Stock Awards other than Incentive Stock Options may be granted to Employees, Directors and Consultants.

**(b) Ten Percent Stockholders.** A Ten Percent Stockholder shall not be granted an Incentive Stock Option unless the exercise price of such Option is at least one hundred ten percent (110%) of the Fair Market Value of the Common Stock on the date of grant and the Option is not exercisable after the expiration of five (5) years from the date of grant.

**(c) Section 162(m) Limitation on Annual Grants.** Subject to the provisions of Section 11(a) relating to Capitalization Adjustments, and except with respect to Awards covering Inducement Shares, at such time as the Company may be subject to the applicable provisions of Section 162(m) of the Code, no Employee shall be eligible to be granted during any calendar year Stock Awards whose value is determined by reference to an increase over an exercise or strike price of at least one hundred percent (100%) of the Fair Market Value of the Common Stock on the date the Stock Award is granted covering more than two hundred fifty thousand (250,000) shares of Common Stock.

**(d) Consultants.** A Consultant shall not be eligible for the grant of a Stock Award if, at the time of grant, a Form S-8 Registration Statement under the Securities Act ( *Form S-8* ) is not available to register either the offer or the sale of the Company's securities to such Consultant because of the nature of the services that the Consultant is providing to the Company, because the Consultant is not a natural person, or because of any other rule governing the use of Form S-8.

**(e) Inducement Shares.** This Section 5(e) shall apply with respect to the One hundred thousand (100,000) shares of Common Stock reserved under this Plan by action of the Board on December 1, 2005 (the *Inducement Shares* ). An Award covering Inducement Shares may be granted only to an Employee not previously an Employee or Director of the Company, or following a *bona fide* period of non-employment, as an inducement material to the individual's entering into employment with the Company within the meaning of Rule 4350(i)(1)(A) of the NASD Marketplace Rules. In addition, notwithstanding any other provision of the Plan to the contrary, all such Awards covering Inducement Shares must be granted either by a majority of the Company's independent directors or a committee comprised of a majority of independent directors.

**6. OPTION PROVISIONS.**

Each Option shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. All Options shall be separately designated Incentive Stock Options or Nonstatutory Stock Options at the time of grant, and, if certificates are issued, a separate certificate or certificates shall be issued for shares of Common Stock purchased on exercise of each type of Option. If an Option is not specifically designated as an Incentive Stock Option, then the Option shall be a Nonstatutory Stock Option. The provisions of separate Options need not be identical; *provided, however*, that each Option Agreement shall include (through incorporation of provisions hereof by reference in the Option Agreement or otherwise) the substance of each of the following provisions:

**(a) Term.** Subject to the provisions of Section 5(b), no Option shall be exercisable after the expiration of ten (10) years from the date of its grant.

**(b) Exercise Price of an Incentive Stock Option.** Subject to the provisions of Section 5(b) regarding Ten Percent Stockholders, the exercise price of each Incentive Stock Option shall be not less than one hundred percent (100%) of the Fair Market Value of the Common Stock subject to the Option on the date the Option is granted. Notwithstanding the foregoing, an Incentive Stock Option may be granted with an exercise price lower than that set forth in the preceding sentence if such Option is granted pursuant to an assumption or substitution for another option in a manner consistent with the provisions of Section 424(a) of the Code.

**(c) Exercise Price of a Nonstatutory Stock Option.** The exercise price of each Nonstatutory Stock Option shall be not less than one hundred percent (100%) of the Fair Market Value of the Common Stock subject to the Option on the date the Option is granted. Notwithstanding the foregoing, a Nonstatutory Stock Option may be granted with an exercise price lower than one hundred percent (100%) of the Fair Market Value of the Common Stock if such Option is granted pursuant to an assumption or substitution for another option in a manner consistent with the provisions of Section 424(a) of the Code.

**(d) Consideration.** The purchase price of Common Stock acquired pursuant to the exercise of an Option shall be paid, to the extent permitted by applicable law and as determined by the Board in its sole discretion, by any combination of the methods of payment set forth below. The Board shall have the authority to grant Options that do not permit all of the following methods of payment (or otherwise restrict the ability to use certain methods) and to grant Options that require the consent of the Company to utilize a particular method of payment. The methods of payment permitted by this Section 6(d) are:

(i) by cash or check;

(ii) bank draft or money order payable to the Company;

(iii) pursuant to a program developed under Regulation T as promulgated by the Federal Reserve Board that, prior to the issuance of Common Stock, results in either the receipt of cash (or check) by the Company or the receipt of irrevocable instructions to pay the aggregate exercise price to the Company from the sales proceeds;

(iv) by delivery to the Company (either by actual delivery or attestation) of shares of Common Stock;

(v) by a net exercise arrangement pursuant to which the Company will reduce the number of shares of Common Stock issued upon exercise by the largest whole number of shares with a Fair Market Value that does not exceed the aggregate exercise price; *provided, however*, that the Company shall accept a cash or other payment from the Participant to the extent of any remaining balance of the aggregate exercise price not satisfied by such reduction in the number of whole shares; *provided, further*, that shares of Common Stock will no longer be outstanding under an Option and will not be exercisable thereafter to the extent that (A) shares are used to pay the exercise price pursuant to the net exercise, (B) shares are delivered to the Participant as a result of such exercise, and (C) shares are withheld to satisfy tax withholding obligations; or

(vi) in any other form of legal consideration that may be acceptable to the Board; *provided, however*, that such form of consideration may not include deferred payment through the use of a promissory note.

**(e) Transferability of Options.** The Board may, in its sole discretion, impose such limitations on the transferability of Options as the Board shall determine. In the absence of such a determination by the Board to the contrary, the following restrictions on the transferability of Options shall apply:

**(i) Restrictions on Transfer.** An Option shall not be transferable except by will or by the laws of descent and distribution and shall be exercisable during the lifetime of the Optionholder only by the Optionholder; provided, however, that the Board may, in its sole discretion, permit transfer of the Option upon the Optionholder's request, provided that such transfer is in compliance with applicable tax and securities laws.

**(ii) Domestic Relations Orders.** Notwithstanding the foregoing, an Option may be transferred pursuant to a domestic relations order.

**(iii) Beneficiary Designation.** Notwithstanding the foregoing, the Optionholder may, by delivering written notice to the Company, in a form provided by or otherwise satisfactory to the Company, designate a third party who, in the event of the death of the Optionholder, shall thereafter be entitled to exercise the Option.

**(f) Vesting Generally.** The total number of shares of Common Stock subject to an Option may vest and therefore become exercisable in periodic installments that may or may not be equal. The Option may be subject

to such other terms and conditions on the time or times when it may or may not be exercised (which may be based on the satisfaction of Performance Goals or other criteria) as the Board may deem appropriate. The vesting provisions of individual Options may vary. The provisions of this Section 6(f) are subject to any Option provisions governing the minimum number of shares of Common Stock as to which an Option may be exercised.

**(g) Termination of Continuous Service.** In the event that an Optionholder's Continuous Service terminates (other than for Cause or upon the Optionholder's death or Disability), the Optionholder may exercise his or her Option (to the extent that the Optionholder was entitled to exercise such Option as of the date of termination of Continuous Service) but only within such period of time ending on the earlier of (i) the date three (3) months following the termination of the Optionholder's Continuous Service (or such longer or shorter period specified in the Option Agreement), or (ii) the expiration of the term of the Option as set forth in the Option Agreement. If, after termination of Continuous Service, the Optionholder does not exercise his or her Option within the time specified herein or in the Option Agreement (as applicable), the Option shall terminate.

**(h) Extension of Termination Date.** An Optionholder's Option Agreement may provide that if the exercise of the Option following the termination of the Optionholder's Continuous Service (other than for Cause or upon the Optionholder's death or Disability or upon a Change in Control) would be prohibited at any time solely because the issuance of shares of Common Stock would violate the registration requirements under the Securities Act, then the Option shall terminate on the earlier of (i) the expiration of a period of three (3) months after the termination of the Optionholder's Continuous Service during which the exercise of the Option would not be in violation of such registration requirements, or (ii) the expiration of the term of the Option as set forth in the Option Agreement.

**(i) Disability of Optionholder.** In the event that an Optionholder's Continuous Service terminates as a result of the Optionholder's Disability, the Optionholder may exercise his or her Option (to the extent that the Optionholder was entitled to exercise such Option as of the date of termination of Continuous Service), but only within such period of time ending on the earlier of (i) the date twelve (12) months following such termination of Continuous Service (or such longer or shorter period specified in the Option Agreement), or (ii) the expiration of the term of the Option as set forth in the Option Agreement. If, after termination of Continuous Service, the Optionholder does not exercise his or her Option within the time specified herein or in the Option Agreement (as applicable), the Option shall terminate.

**(j) Death of Optionholder.** In the event that (i) an Optionholder's Continuous Service terminates as a result of the Optionholder's death, or (ii) the Optionholder dies within the period (if any) specified in the Option Agreement after the termination of the Optionholder's Continuous Service for a reason other than death, then the Option may be exercised (to the extent the Optionholder was entitled to exercise such Option as of the date of death) by the Optionholder's estate, by a person who acquired the right to exercise the Option by bequest or inheritance or by a person designated to exercise the option upon the Optionholder's death, but only within the period ending on the earlier of (i) the date eighteen (18) months following the date of death (or such longer or shorter period specified in the Option Agreement), or (ii) the expiration of the term of such Option as set forth in the Option Agreement. If, after the Optionholder's death, the Option is not exercised within the time specified herein or in the Option Agreement (as applicable), the Option shall terminate.

**(k) Termination for Cause.** Except as explicitly provided otherwise in an Optionholder's Option Agreement, in the event that an Optionholder's Continuous Service is terminated for Cause, the Option shall terminate upon the termination date of such Optionholder's Continuous Service, and the Optionholder shall be prohibited from exercising his or her Option from and after the time of such termination of Continuous Service.

#### **7. PROVISIONS OF STOCK AWARDS OTHER THAN OPTIONS.**

**(a) Stock Purchase Awards.** Each Stock Purchase Award Agreement shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. To the extent consistent with the

Company's Bylaws, at the Board's election, shares of Common Stock may be (x) held in book entry form subject to the Company's instructions until any restrictions relating to the Stock Purchase Award lapse; or (y) evidenced by a certificate, which certificate shall be held in such form and manner as determined by the Board. The terms and conditions of Stock Purchase Award Agreements may change from time to time, and the terms and conditions of separate Stock Purchase Award Agreements need not be identical, *provided, however*, that each Stock Purchase Award Agreement shall include (through incorporation of the provisions hereof by reference in the Agreement or otherwise) the substance of each of the following provisions:

**(i) Purchase Price.** At the time of the grant of a Stock Purchase Award, the Board will determine the price to be paid by the Participant for each share subject to the Stock Purchase Award. To the extent required by applicable law, the price to be paid by the Participant for each share of the Stock Purchase Award will not be less than the par value of a share of Common Stock.

**(ii) Consideration.** At the time of the grant of a Stock Purchase Award, the Board will determine the consideration permissible for the payment of the purchase price of the Stock Purchase Award. The purchase price of Common Stock acquired pursuant to the Stock Purchase Award shall be paid either: (A) in cash or by check at the time of purchase, (B) by past or future services actually rendered to the Company or an Affiliate, or (C) in any other form of legal consideration that may be acceptable to the Board in its sole discretion and permissible under applicable law.

**(iii) Vesting.** Shares of Common Stock acquired under a Stock Purchase Award may be subject to a share repurchase right or option in favor of the Company in accordance with a vesting schedule to be determined by the Board.

**(iv) Termination of Participant's Continuous Service.** In the event that a Participant's Continuous Service terminates, the Company shall have the right, but not the obligation, to repurchase or otherwise reacquire, any or all of the shares of Common Stock held by the Participant that have not vested as of the date of termination under the terms of the Stock Purchase Award Agreement. At the Board's election, the price paid for all shares of Common Stock so repurchased or reacquired by the Company may be at the lesser of: (A) the Fair Market Value on the relevant date, or (B) the Participant's original cost for such shares. The Company shall not be required to exercise its repurchase or reacquisition option until at least six (6) months (or such longer or shorter period of time necessary to avoid a charge to earnings for financial accounting purposes) have elapsed following the Participant's purchase of the shares of Common Stock acquired pursuant to the Stock Purchase Award unless otherwise determined by the Board or provided in the Stock Purchase Award Agreement.

**(v) Transferability.** Rights to purchase or receive shares of Common Stock granted under a Stock Purchase Award shall be transferable by the Participant only upon such terms and conditions as are set forth in the Stock Purchase Award Agreement, as the Board shall determine in its sole discretion, and so long as Common Stock awarded under the Stock Purchase Award remains subject to the terms of the Stock Purchase Award Agreement.

**(b) Restricted Stock Awards.** Each Restricted Stock Award Agreement shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. To the extent consistent with the Company's Bylaws, at the Board's election, shares of Common Stock may be (x) held in book entry form subject to the Company's instructions until any restrictions relating to the Restricted Stock Award lapse; or (y) evidenced by a certificate, which certificate shall be held in such form and manner as determined by the Board. The terms and conditions of Restricted Stock Award Agreements may change from time to time, and the terms and conditions of separate Restricted Stock Award Agreements need not be identical, *provided, however*, that each Restricted Stock Award Agreement shall include (through incorporation of provisions hereof by reference in the agreement or otherwise) the substance of each of the following provisions:

**(i) Consideration.** A Restricted Stock Award may be awarded in consideration for (A) past or future services actually rendered to the Company or an Affiliate, or (B) any other form of legal consideration that may be acceptable to the Board in its sole discretion and permissible under applicable law.

**(ii) Vesting.** Shares of Common Stock awarded under the Restricted Stock Award Agreement may be subject to forfeiture to the Company in accordance with a vesting schedule to be determined by the Board.

**(iii) Termination of Participant's Continuous Service.** In the event a Participant's Continuous Service terminates, the Company may receive via a forfeiture condition, any or all of the shares of Common Stock held by the Participant which have not vested as of the date of termination of Continuous Service under the terms of the Restricted Stock Award Agreement.

**(iv) Transferability.** Rights to acquire shares of Common Stock under the Restricted Stock Award Agreement shall be transferable by the Participant only upon such terms and conditions as are set forth in the Restricted Stock Award Agreement, as the Board shall determine in its sole discretion, so long as Common Stock awarded under the Restricted Stock Award Agreement remains subject to the terms of the Restricted Stock Award Agreement.

**(c) Restricted Stock Unit Awards.** Each Restricted Stock Unit Award Agreement shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. The terms and conditions of Restricted Stock Unit Award Agreements may change from time to time, and the terms and conditions of separate Restricted Stock Unit Award Agreements need not be identical, *provided, however*, that each Restricted Stock Unit Award Agreement shall include (through incorporation of the provisions hereof by reference in the Agreement or otherwise) the substance of each of the following provisions:

**(i) Consideration.** At the time of grant of a Restricted Stock Unit Award, the Board will determine the consideration, if any, to be paid by the Participant upon delivery of each share of Common Stock subject to the Restricted Stock Unit Award. The consideration to be paid (if any) by the Participant for each share of Common Stock subject to a Restricted Stock Unit Award may be paid in any form of legal consideration that may be acceptable to the Board in its sole discretion and permissible under applicable law.

**(ii) Vesting.** At the time of the grant of a Restricted Stock Unit Award, the Board may impose such restrictions or conditions to the vesting of the Restricted Stock Unit Award as it, in its sole discretion, deems appropriate.

**(iii) Payment.** A Restricted Stock Unit Award may be settled by the delivery of shares of Common Stock, their cash equivalent, any combination thereof or in any other form of consideration, as determined by the Board and contained in the Restricted Stock Unit Award Agreement.

**(iv) Additional Restrictions.** At the time of the grant of a Restricted Stock Unit Award, the Board, as it deems appropriate, may impose such restrictions or conditions that delay the delivery of the shares of Common Stock (or their cash equivalent) subject to a Restricted Stock Unit Award after the vesting of such Restricted Stock Unit Award.

**(v) Dividend Equivalents.** Dividend equivalents may be credited in respect of shares of Common Stock covered by a Restricted Stock Unit Award, as determined by the Board and contained in the Restricted Stock Unit Award Agreement. At the sole discretion of the Board, such dividend equivalents may be converted into additional shares of Common Stock covered by the Restricted Stock Unit Award in such manner as determined by the Board. Any additional shares covered by the Restricted Stock Unit Award credited by reason of such dividend equivalents will be subject to all the terms and conditions of the underlying Restricted Stock Unit Award Agreement to which they relate.

**(vi) Termination of Participant's Continuous Service.** Except as otherwise provided in the applicable Restricted Stock Unit Award Agreement, such portion of the Restricted Stock Unit Award that has not vested will be forfeited upon the Participant's termination of Continuous Service.

**(vii) Compliance with Section 409A of the Code.** Notwithstanding anything to the contrary set forth herein, any Restricted Stock Unit Award granted under the Plan that is not exempt from the requirements of Section 409A of the Code shall contain such provisions so that such Restricted Stock Unit Award will comply with the requirements of Section 409A of the Code. Such restrictions, if any, shall be determined by the Board and contained in the Restricted Stock Unit Award Agreement evidencing such Restricted Stock



Unit Award. For example, such restrictions may include, without limitation, a requirement that any Common Stock that is to be issued in a year following the year in which the Restricted Stock Unit Award vests must be issued in accordance with a fixed pre-determined schedule.

**(d) Stock Appreciation Rights.** Each Stock Appreciation Right Agreement shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. Stock Appreciation Rights may be granted as stand-alone Stock Awards or in tandem with other Stock Awards. The terms and conditions of Stock Appreciation Right Agreements may change from time to time, and the terms and conditions of separate Stock Appreciation Right Agreements need not be identical; *provided, however*, that each Stock Appreciation Right Agreement shall include (through incorporation of the provisions hereof by reference in the Agreement or otherwise) the substance of each of the following provisions:

**(i) Term.** No Stock Appreciation Right shall be exercisable after the expiration of ten (10) years from the date of its grant.

**(ii) Strike Price.** Each Stock Appreciation Right will be denominated in shares of Common Stock equivalents. The strike price of each Stock Appreciation Right granted as a stand-alone or tandem Stock Award shall not be less than one hundred percent (100%) of the Fair Market Value of the Common Stock equivalents subject to the Stock Appreciation Right on the date of grant.

**(iii) Calculation of Appreciation.** The appreciation distribution payable on the exercise of a Stock Appreciation Right will be not greater than an amount equal to the excess of (A) the aggregate Fair Market Value (on the date of the exercise of the Stock Appreciation Right) of a number of shares of Common Stock equal to the number of share of Common Stock equivalents in which the Participant is vested under such Stock Appreciation Right, and with respect to which the Participant is exercising the Stock Appreciation Right on such date, over (B) the strike price that will be determined by the Board at the time of grant of the Stock Appreciation Right.

**(iv) Vesting.** At the time of the grant of a Stock Appreciation Right, the Board may impose such restrictions or conditions to the vesting of such Stock Appreciation Right as it, in its sole discretion, deems appropriate.

**(v) Exercise.** To exercise any outstanding Stock Appreciation Right, the Participant must provide written notice of exercise to the Company in compliance with the provisions of the Stock Appreciation Right Agreement evidencing such Stock Appreciation Right.

**(vi) Payment.** The appreciation distribution in respect to a Stock Appreciation Right may be paid in Common Stock, in cash, in any combination of the two or in any other form of consideration, as determined by the Board and contained in the Stock Appreciation Right Agreement evidencing such Stock Appreciation Right.

**(vii) Termination of Continuous Service.** In the event that a Participant's Continuous Service terminates (other than for Cause), the Participant may exercise his or her Stock Appreciation Right (to the extent that the Participant was entitled to exercise such Stock Appreciation Right as of the date of termination) but only within such period of time ending on the earlier of (A) the date three (3) months following the termination of the Participant's Continuous Service (or such longer or shorter period specified in the Stock Appreciation Right Agreement), or (B) the expiration of the term of the Stock Appreciation Right as set forth in the Stock Appreciation Right Agreement. If, after termination, the Participant does not exercise his or her Stock Appreciation Right within the time specified herein or in the Stock Appreciation Right Agreement (as applicable), the Stock Appreciation Right shall terminate.

**(viii) Termination for Cause.** Except as explicitly provided otherwise in an Participant's Stock Appreciation Right Agreement, in the event that a Participant's Continuous Service is terminated for Cause, the Stock Appreciation Right shall terminate upon the termination date of such Participant's Continuous Service, and the Participant shall be prohibited from exercising his or her Stock Appreciation Right from and after the time of such termination of Continuous Service.

**(ix) Compliance with Section 409A of the Code.** Notwithstanding anything to the contrary set forth herein, any Stock Appreciation Rights granted under the Plan that are not exempt from the requirements of Section 409A of the Code shall contain such provisions so that such Stock Appreciation Rights will comply with the requirements of Section 409A of the Code. Such restrictions, if any, shall be determined by the Board and contained in the Stock Appreciation Right Agreement evidencing such Stock Appreciation Right. For example, such restrictions may include, without limitation, a requirement that a Stock Appreciation Right that is to be paid wholly or partly in cash must be exercised and paid in accordance with a fixed pre-determined schedule.

**(e) Other Stock Awards.** Other forms of Stock Awards valued in whole or in part by reference to, or otherwise based on, Common Stock may be granted either alone or in addition to Stock Awards provided for under Section 6 and the preceding provisions of this Section 7. Subject to the provisions of the Plan, the Board shall have sole and complete authority to determine the persons to whom and the time or times at which such Other Stock Awards will be granted, the number of shares of Common Stock (or the cash equivalent thereof) to be granted pursuant to such Other Stock Awards and all other terms and conditions of such Other Stock Awards.

#### **8. COVENANTS OF THE COMPANY.**

**(a) Availability of Shares.** During the terms of the Stock Awards, the Company shall keep available at all times the number of shares of Common Stock required to satisfy such Stock Awards.

**(b) Securities Law Compliance.** The Company shall seek to obtain from each regulatory commission or agency having jurisdiction over the Plan such authority as may be required to grant Stock Awards and to issue and sell shares of Common Stock upon exercise of the Stock Awards; *provided, however*, that this undertaking shall not require the Company to register under the Securities Act the Plan, any Stock Award or any Common Stock issued or issuable pursuant to any such Stock Award. If, after reasonable efforts, the Company is unable to obtain from any such regulatory commission or agency the authority that counsel for the Company deems necessary for the lawful issuance and sale of Common Stock under the Plan, the Company shall be relieved from any liability for failure to issue and sell Common Stock upon exercise of such Stock Awards unless and until such authority is obtained.

#### **9. USE OF PROCEEDS FROM SALES OF COMMON STOCK.**

Proceeds from the sale of shares of Common Stock pursuant to Stock Awards shall constitute general funds of the Company.

#### **10. MISCELLANEOUS.**

**(a) Corporate Action Constituting Grant of Stock Awards.** Corporate action constituting an offer by the Company of Common Stock to any Participant under the terms of a Stock Award shall be deemed completed as of the date of such corporate action, unless otherwise determined by the Board, regardless of when the instrument, certificate, or letter evidencing the Stock Award is actually received or accepted by the Participant.

**(b) Stockholder Rights.** No Participant shall be deemed to be the holder of, or to have any of the rights of a holder with respect to, any shares of Common Stock subject to such Stock Award unless and until such Participant has satisfied all requirements for exercise of the Stock Award pursuant to its terms.

**(c) No Employment or Other Service Rights.** Nothing in the Plan, any Stock Award Agreement or other instrument executed thereunder or in connection with any Award granted pursuant to the Plan shall confer upon any Participant any right to continue to serve the Company or an Affiliate in the capacity in effect at the time the Stock Award was granted or shall affect the right of the Company or an Affiliate to terminate (i) the employment of an Employee with or without notice and with or without cause, (ii) the service of a Consultant pursuant to the

terms of such Consultant's agreement with the Company or an Affiliate, or (iii) the service of a Director pursuant to the Bylaws of the Company or an Affiliate, and any applicable provisions of the corporate law of the state in which the Company or the Affiliate is incorporated, as the case may be.

**(d) Incentive Stock Option \$100,000 Limitation.** To the extent that the aggregate Fair Market Value (determined at the time of grant) of Common Stock with respect to which Incentive Stock Options are exercisable for the first time by any Optionholder during any calendar year (under all plans of the Company and any Affiliates) exceeds one hundred thousand dollars (\$100,000), the Options or portions thereof that exceed such limit (according to the order in which they were granted) shall be treated as Nonstatutory Stock Options, notwithstanding any contrary provision of the applicable Option Agreement(s).

**(e) Investment Assurances.** The Company may require a Participant, as a condition of exercising or acquiring Common Stock under any Stock Award, (i) to give written assurances satisfactory to the Company as to the Participant's knowledge and experience in financial and business matters and/or to employ a purchaser representative reasonably satisfactory to the Company who is knowledgeable and experienced in financial and business matters and that he or she is capable of evaluating, alone or together with the purchaser representative, the merits and risks of exercising the Stock Award; and (ii) to give written assurances satisfactory to the Company stating that the Participant is acquiring Common Stock subject to the Stock Award for the Participant's own account and not with any present intention of selling or otherwise distributing the Common Stock. The foregoing requirements, and any assurances given pursuant to such requirements, shall be inoperative if (x) the issuance of the shares upon the exercise or acquisition of Common Stock under the Stock Award has been registered under a then currently effective registration statement under the Securities Act, or (y) as to any particular requirement, a determination is made by counsel for the Company that such requirement need not be met in the circumstances under the then applicable securities laws. The Company may, upon advice of counsel to the Company, place legends on stock certificates issued under the Plan as such counsel deems necessary or appropriate in order to comply with applicable securities laws, including, but not limited to, legends restricting the transfer of the Common Stock.

**(f) Withholding Obligations.** To the extent provided by the terms of a Stock Award Agreement, the Company may, in its sole discretion, satisfy any federal, state or local tax withholding obligation relating to a Stock Award by any of the following means (in addition to the Company's right to withhold from any compensation paid to the Participant by the Company) or by a combination of such means: (i) causing the Participant to tender a cash payment; (ii) withholding shares of Common Stock from the shares of Common Stock issued or otherwise issuable to the Participant in connection with the Stock Award; or (iii) by such other method as may be set forth in the Stock Award Agreement.

**(g) Electronic Delivery.** Any reference herein to a written agreement or document shall include any agreement or document delivered electronically or posted on the Company's intranet.

**(h) Performance Stock Awards.** A Performance Stock Award is a Stock Award that may be granted, may vest, or may be exercised based upon the attainment during a Performance Period of certain Performance Goals. A Performance Stock Award may, but need not, require the completion of a specified period of Continuous Service. The length of any Performance Period, the Performance Goals to be achieved during the Performance Period, and the measure of whether and to what degree such Performance Goals have been attained shall be conclusively determined by the Committee in its sole discretion. The maximum benefit to be received by any Participant in any calendar year attributable to Stock Awards described in this Section 10(h) shall not exceed the value of two hundred fifty thousand (250,000) shares of Common Stock.

#### **11. ADJUSTMENTS UPON CHANGES IN COMMON STOCK; OTHER CORPORATE EVENTS.**

**(a) Capitalization Adjustments.** If any change is made in, or other events occur with respect to, the Common Stock subject to the Plan or subject to any Stock Award after the Effective Date without the receipt of

consideration by the Company (through merger, consolidation, reorganization, recapitalization, reincorporation, stock dividend, dividend in property other than cash, stock split, liquidating dividend, combination of shares, exchange of shares, change in corporate structure or other transaction not involving the receipt of consideration by the Company (each a **Capitalization Adjustment**)), the Board shall appropriately adjust: (i) the class(es) and maximum number of securities subject to the Plan pursuant to Section 4(a), (ii) the class(es) and maximum number of securities that may be issued pursuant to the exercise of Incentive Stock Options pursuant to Section 4(b), (iii) the class(es) and maximum number of securities that may be awarded to any person pursuant to Section 5(c) and 10(h), and (iv) the class(es) and number of securities and price per share of stock subject to outstanding Stock Awards. The Board shall make such adjustments, and its determination shall be final, binding and conclusive. (Notwithstanding the foregoing, the conversion of any convertible securities of the Company shall not be treated as a transaction without receipt of consideration by the Company.)

**(b) Dissolution or Liquidation.** In the event of a dissolution or liquidation of the Company, all outstanding Options and Stock Appreciation Rights shall terminate immediately prior to the completion of such dissolution or liquidation.

**(c) Corporate Transaction.** The following provisions shall apply to Stock Awards in the event of a Corporate Transaction unless otherwise provided in the instrument evidencing the Stock Award or any other written agreement between the Company or any Affiliate and the holder of the Stock Award or unless otherwise expressly provided by the Board at the time of grant of a Stock Award.

**(i) Stock Awards May Be Assumed.** In the event of a Corporate Transaction, any surviving corporation or acquiring corporation (or the surviving or acquiring corporation's parent company) may assume or continue any or all Stock Awards outstanding under the Plan or may substitute similar stock awards for Stock Awards outstanding under the Plan (including but not limited to, awards to acquire the same consideration paid to the stockholders of the Company pursuant to the Corporate Transaction), and any reacquisition or repurchase rights held by the Company in respect of Common Stock issued pursuant to Stock Awards may be assigned by the Company to the successor of the Company (or the successor's parent company, if any), in connection with such Corporate Transaction. A surviving corporation or acquiring corporation (or its parent) may choose to assume or continue only a portion of a Stock Award or substitute a similar stock award for only a portion of a Stock Award. The terms of any assumption, continuation or substitution shall be set by the Board in accordance with the provisions of Section 3.

**(ii) Stock Awards Held by Current Participants.** In the event of a Corporate Transaction in which the surviving corporation or acquiring corporation (or its parent company) does not assume or continue such outstanding Stock Awards or substitute similar stock awards for such outstanding Stock Awards, then with respect to Stock Awards that have not been assumed, continued or substituted and that are held by Participants whose Continuous Service has not terminated prior to the effective time of the Corporate Transaction (referred to as the **Current Participants**), the vesting of such Stock Awards (and, if applicable, the time at which such Stock Awards may be exercised) shall (contingent upon the effectiveness of the Corporate Transaction) be accelerated in full to a date prior to the effective time of such Corporate Transaction as the Board shall determine (or, if the Board shall not determine such a date, to the date that is five (5) days prior to the effective time of the Corporate Transaction), and such Stock Awards shall terminate if not exercised (if applicable) at or prior to the effective time of the Corporate Transaction, and any reacquisition or repurchase rights held by the Company with respect to such Stock Awards shall lapse (contingent upon the effectiveness of the Corporate Transaction).

**(iii) Stock Awards Held by Persons other than Current Participants.** In the event of a Corporate Transaction in which the surviving corporation or acquiring corporation (or its parent company) does not assume or continue such outstanding Stock Awards or substitute similar stock awards for such outstanding Stock Awards, then with respect to Stock Awards that have not been assumed, continued or substituted and that are held by persons other than Current Participants, the vesting of such Stock Awards (and, if applicable, the time at which such Stock Award may be exercised) shall not be accelerated and such Stock Awards (other than a Stock Award consisting of vested and outstanding shares of Common Stock not

subject to the Company's right of repurchase) shall terminate if not exercised (if applicable) prior to the effective time of the Corporate Transaction; *provided, however*, that any reacquisition or repurchase rights held by the Company with respect to such Stock Awards shall not terminate and may continue to be exercised notwithstanding the Corporate Transaction.

**(iv) Payment for Stock Awards in Lieu of Exercise.** Notwithstanding the foregoing, in the event a Stock Award will terminate if not exercised prior to the effective time of a Corporate Transaction, the Board may provide, in its sole discretion, that the holder of such Stock Award may not exercise such Stock Award but will receive a payment, in such form as may be determined by the Board, equal in value to the excess, if any, of (A) the value of the property the holder of the Stock Award would have received upon the exercise of the Stock Award, over (B) any exercise price payable by such holder in connection with such exercise.

**(d) Change in Control.** Notwithstanding anything to the contrary contained in Section 11(c) of the Plan, upon a Change in Control event described in Section 2(e)(i), 2(e)(ii), 2(e)(iii) or 2(e)(iv), each Stock Award held by a Participant whose Continuous Service has not terminated as of the date immediately prior to the effective date of such Change in Control shall automatically become fully vested (and any reacquisition or repurchase rights held by the Company with respect to the shares of Common Stock subject to such acceleration shall lapse in full, as appropriate) and, if applicable, each such Stock Award shall become immediately exercisable in full. In addition, a Stock Award may be subject to additional acceleration of vesting and exercisability upon or after a Change in Control described in Section 2(e)(v) as may be provided in the Stock Award Agreement for such Stock Award or as may be provided in any other written agreement between the Company or any Affiliate and the Participant, but in the absence of such provision, no such acceleration shall occur.

**(e) Parachute Payments.**

**(i)** If the acceleration of the vesting and exercisability of Stock Awards provided for in Sections 11(c) and 11(d), together with payments and other benefits of a Participant (collectively, the **Payment**) (i) constitute a parachute payment within the meaning of Section 280G of the Code, or any comparable successor provisions, and (ii) but for this Section 11(e) would be subject to the excise tax imposed by Section 4999 of the Code, or any comparable successor provisions (the **Excise Tax**), then such Payment shall be either (1) provided to such Participant in full, or (2) provided to such Participant as to such lesser extent that would result in no portion of such Payment being subject to the Excise Tax, whichever of the foregoing amounts, when taking into account applicable federal, state, local and foreign income and employment taxes, the Excise Tax, and any other applicable taxes, results in the receipt by such Participant, on an after-tax basis, of the greatest amount of the Payment, notwithstanding that all or some portion of the Payment may be subject to the Excise Tax.

**(ii)** The Company shall appoint a nationally recognized independent accounting firm (the **Accountant**) to make the determinations required hereunder, which accounting firm shall not then be serving as accountant or auditor for the individual, entity or group that effected the Change in Control. The Company shall bear all costs and expenses with respect to the determinations the Accountant may reasonably incur in connection with any calculations contemplated by this Section 11(e).

**(iii)** Unless the Company and such Participant otherwise agree in writing, any determination required under this Section 11(e) shall be made in writing in good faith by the Accountant. If a reduction in the Payment is to be made as provided above, reductions shall occur in the following order unless the Participant elects in writing a different order (*provided, however*, that such election shall be subject to Company approval if made on or after the date that triggers the Payment or a portion thereof): (A) reduction of cash payments; (B) cancellation of accelerated vesting of Options and other Stock Awards; and (C) reduction of other benefits paid to the Participant. If acceleration of vesting of Stock Awards is to be reduced, such acceleration of vesting shall be cancelled in the reverse order of date of grant of the Stock Awards (*i.e.*, the earliest granted Stock Award cancelled last) unless the Participant elects in writing a different order for cancellation.

(iv) For purposes of making the calculations required by this Section 11(e), the Accountant may make reasonable assumptions and approximations concerning applicable taxes and may rely on reasonable, good faith interpretations concerning the application of the Code and other applicable legal authority. The Company and the Participant shall furnish to the Accountant such information and documents as the Accountant may reasonably request in order to make such a determination.

(v) If, notwithstanding any reduction described above, the Internal Revenue Service (the **IRS**) determines that the Participant is liable for the Excise Tax as a result of the Payment, then the Participant shall be obligated to pay back to the Company, within thirty (30) days after a final IRS determination or, in the event that the Participant challenges the final IRS determination, a final judicial determination, a portion of the Payment (the **Repayment Amount**). The Repayment Amount with respect to the Payment shall be the smallest such amount, if any, as shall be required to be paid to the Company so that the Participant's net after-tax proceeds with respect to the Payment (after taking into account the payment of the Excise Tax and all other applicable taxes imposed on the Payment) shall be maximized. The Repayment Amount with respect to the Payment shall be zero if a Repayment Amount of more than zero would not result in the Participant's net after-tax proceeds with respect to the Payment being maximized. If the Excise Tax is not eliminated pursuant to this paragraph, the Optionholder shall pay the Excise Tax.

(vi) Notwithstanding any other provision of this Section 11(e), if (A) there is a reduction in the Payment as described above, (B) the IRS later determines that the Participant is liable for the Excise Tax, the payment of which would result in the maximization of the Participant's net after-tax proceeds of the Payment (calculated as if the Payment had not previously been reduced), and (C) the Participant the Excise Tax, then the Company shall pay or otherwise provide to the Participant that portion of the Payment that was reduced pursuant to this Section 11(e) contemporaneously or as soon as administratively possible after the Optionholder pays the Excise Tax so that the Participant's net after-tax proceeds with respect to the Payment are maximized.

(vii) If the Participant either (A) brings any action to enforce rights pursuant to this Section 11(e), or (B) defends any legal challenge to his or her rights under this Section 11(e), the Participant shall be entitled to recover attorneys' fees and costs incurred in connection with such action, regardless of the outcome of such action; *provided, however*, that if such action is commenced by the Participant, the court finds that the action was brought in good faith.

#### **12. TERMINATION OR SUSPENSION OF THE PLAN.**

(a) **Plan Term.** Unless sooner terminated by the Board pursuant to Section 3, the Plan shall automatically terminate on the day before the tenth (10th) anniversary of the date the Plan is adopted by the Board or approved by the stockholders of the Company, whichever is earlier. No Awards may be granted under the Plan while the Plan is suspended or after it is terminated.

(b) **No Impairment of Rights.** Termination of the Plan shall not impair rights and obligations under any Award granted while the Plan is in effect except with the written consent of the affected Participant.

#### **13. EFFECTIVE DATE OF PLAN.**

This Plan shall become effective on the Effective Date.

#### **14. CHOICE OF LAW.**

The law of the State of California shall govern all questions concerning the construction, validity and interpretation of this Plan, without regard to such state's conflict of laws rules.

HOLLIS-EDEN PHARMACEUTICALS, INC.

2005 NON-EMPLOYEE DIRECTORS EQUITY INCENTIVE PLAN

AS AMENDED ON MARCH 18, 2006

1. GENERAL.

(a) **Eligible Stock Award Recipients.** The persons eligible to receive Stock Awards are the Non-Employee Directors of the Company.

(b) **Available Stock Awards.** The Plan provides for the grant of the following Stock Awards: (i) Nonstatutory Stock Options, (ii) Stock Purchase Awards, (iii) Restricted Stock Awards, (iv) Stock Appreciation Rights, (v) Restricted Stock Unit Awards, and (vi) Other Stock Awards.

(c) **General Purpose.** The Company, by means of the Plan, seeks to retain the services of its Non-Employee Directors, to secure and retain the services of new Non-Employee Directors and to provide incentives for such persons to exert maximum efforts for the success of the Company and any Affiliate and to provide a means by which such persons may be given an opportunity to benefit from increases in value of the Common Stock through the granting of Stock Awards.

2. DEFINITIONS.

As used in the Plan, the following definitions shall apply to the capitalized terms indicated below:

(a) **Affiliate** means (i) any corporation (other than the Company) in an unbroken ownership chain of corporations ending with the Company, provided each corporation in the unbroken ownership chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such ownership chain, and (ii) any corporation (other than the Company) in an unbroken ownership chain of corporations beginning with the Company, provided each corporation (other than the last corporation) in the unbroken ownership chain owns, at the time of the determination, stock possessing fifty percent (50%) or more of the total combined voting power of all classes of stock in one of the other corporations in such ownership chain. The Board shall have the authority to determine (x) the time or times at which the ownership tests are applied, and (y) whether **Affiliate** includes entities other than corporations within the foregoing definition.

(b) **Board** means the Board of Directors of the Company.

(c) **Capitalization Adjustment** has the meaning ascribed to that term in Section 11(a).

(d) **Cause** means, with respect to a Participant, the occurrence of any of the following: (i) such Participant's commission of any felony or any crime involving fraud, dishonesty or moral turpitude under the laws of the United States or any state thereof; (ii) such Participant's attempted commission of, or participation in, a fraud or act of dishonesty against the Company; (iii) such Participant's intentional, material violation of any contract or agreement between the Participant and the Company or of any statutory duty owed to the Company; (iv) such Participant's unauthorized use or disclosure of the Company's confidential information or trade secrets; or (v) such Participant's gross misconduct. The determination that a termination of the Participant's Continuous Service is either for Cause or without Cause shall be made by the Company in its sole discretion. Any determination by the Company that the Continuous Service of a Participant was terminated by reason of dismissal without Cause for the purposes of outstanding Stock Awards held by such Participant shall have no effect upon any determination of the rights or obligations of the Company or such Participant for any other purpose.

(e) **Change in Control** means the occurrence, in a single transaction or in a series of related transactions, of any one or more of the following events:

(i) any Exchange Act Person becomes the Owner, directly or indirectly, of securities of the Company representing forty percent (40%) or more of the combined voting power of the Company's then outstanding securities other than by virtue of a merger, consolidation or similar transaction. Notwithstanding the foregoing, a Change in Control shall not be deemed to occur (A) on account of the acquisition of securities of the Company by an investor, any affiliate thereof or any other Exchange Act Person from the Company in a transaction or series of related transactions the primary purpose of which is to obtain financing for the Company through the issuance of equity securities or (B) solely because the level of Ownership held by any Exchange Act Person (the **Subject Person**) exceeds the designated percentage threshold of the outstanding voting securities as a result of a repurchase or other acquisition of voting securities by the Company reducing the number of shares outstanding, provided that if a Change in Control would occur (but for the operation of this sentence) as a result of the acquisition of voting securities by the Company, and after such share acquisition, the Subject Person becomes the Owner of any additional voting securities that, assuming the repurchase or other acquisition had not occurred, increases the percentage of the then outstanding voting securities Owned by the Subject Person over the designated percentage threshold, then a Change in Control shall be deemed to occur;

(ii) there is consummated a merger, consolidation or similar transaction involving (directly or indirectly) the Company and, immediately after the consummation of such merger, consolidation or similar transaction, the stockholders of the Company immediately prior thereto, as such, do not Own, directly or indirectly, either (A) outstanding voting securities representing more than sixty percent (60%) of the combined outstanding voting power of the surviving Entity in such merger, consolidation or similar transaction or (B) more than sixty percent (60%) of the combined outstanding voting power of the parent of the surviving Entity in such merger, consolidation or similar transaction, in each case in substantially the same proportions as their Ownership of the outstanding voting securities of the Company immediately prior to such transaction;

(iii) the stockholders of the Company approve or the Board approves a plan of complete dissolution or liquidation of the Company, or a complete dissolution or liquidation of the Company shall otherwise occur;

(iv) there is consummated a sale, lease, exclusive license or other disposition of all or substantially all of the consolidated assets of the Company and its Subsidiaries, other than a sale, lease, license or other disposition of all or substantially all of the consolidated assets of the Company and its Subsidiaries to an Entity, more than fifty percent (50%) of the combined voting power of the voting securities of which are Owned by stockholders of the Company in substantially the same proportions as their Ownership of the outstanding voting securities of the Company immediately prior to such sale, lease, license or other disposition; or

(v) individuals who, on the date this Plan is adopted by the Board, are members of the Board (the **Incumbent Board**) cease for any reason to constitute at least a majority of the members of the Board; *provided, however*, that if the appointment or election (or nomination for election) of any new Board member was approved or recommended by a majority vote of the members of the Incumbent Board then still in office, such new member shall, for purposes of this Plan, be considered as a member of the Incumbent Board.

The term Change in Control shall not include a sale of assets, merger or other transaction effected exclusively for the purpose of changing the domicile of the Company.

Notwithstanding the foregoing or any other provision of this Plan, the definition of Change in Control (or any analogous term) in an individual written agreement between the Company or any Affiliate and the Participant shall supersede the foregoing definition with respect to Stock Awards subject to such agreement; *provided, however*, that if no definition of Change in Control or any analogous term is set forth in such an individual written agreement, the foregoing definition shall apply.



(f) **Code** means the Internal Revenue Code of 1986, as amended.

(g) **Committee** means a committee of one (1) or more Directors to whom authority has been delegated by the Board in accordance with Section 3(c).

(h) **Common Stock** means the common stock of the Company.

(i) **Company** means Hollis-Eden Pharmaceuticals, Inc., a Delaware corporation.

(j) **Consultant** means any person, including an advisor, who is (i) engaged by the Company or an Affiliate to render consulting or advisory services and is compensated for such services, or (ii) serving as a member of the board of directors of an Affiliate and is compensated for such services. However, service solely as a Director, or payment of a fee for such service, shall not cause a Director to be considered a Consultant for purposes of the Plan.

(k) **Continuous Service** means that the Participant's service with the Company or an Affiliate, whether as an Employee, Director or Consultant, is not interrupted or terminated. A change in the capacity in which the Participant renders service to the Company or an Affiliate as an Employee, Consultant or Director or a change in the entity for which the Participant renders such service, provided that there is no interruption or termination of the Participant's service with the Company or an Affiliate, shall not terminate a Participant's Continuous Service. For example, a change in status from a Non-Employee Director of the Company to a Consultant of an Affiliate or an Employee of the Company will not constitute an interruption of Continuous Service. To the extent permitted by law, the Board or the chief executive officer of the Company, in that party's sole discretion, may determine whether Continuous Service shall be considered interrupted in the case of any leave of absence approved by that party, including sick leave, military leave or any other personal leave. Notwithstanding the foregoing, a leave of absence shall be treated as Continuous Service for purposes of vesting in a Stock Award only to such extent as may be provided in the Company's leave of absence policy, in the written terms of any leave of absence agreement or policy applicable to the Participant, or as otherwise required by law.

(l) **Corporate Transaction** means the occurrence, in a single transaction or in a series of related transactions, of any one or more of the following events:

(i) a sale or other disposition of all or substantially all, as determined by the Board in its sole discretion, of the consolidated assets of the Company and its Subsidiaries;

(ii) a sale or other disposition of at least ninety percent (90%) of the outstanding securities of the Company;

(iii) the consummation of a merger, consolidation or similar transaction following which the Company is not the surviving corporation; or

(iv) the consummation of a merger, consolidation or similar transaction following which the Company is the surviving corporation but the shares of Common Stock outstanding immediately preceding the merger, consolidation or similar transaction are converted or exchanged by virtue of the merger, consolidation or similar transaction into other property, whether in the form of securities, cash or otherwise.

(m) **Covered Employee** shall have the meaning provided in Section 162(m)(3) of the Code and the regulations promulgated thereunder.

(n) **Director** means a member of the Board.

(o) **Disability** means the permanent and total disability of a person within the meaning of Section 22(e)(3) of the Code.

(p) **Effective Date** means the effective date of this Plan document, which is the date that this Plan is first approved by the Company's stockholders.

- (q) **Eligible Committee Director** means a Director who either (i) is not a current Employee or officer of the Company or an Affiliate, does not receive compensation, either directly or indirectly, from the Company or an Affiliate for services rendered as a Consultant or in any capacity other than as a Director (except for an amount as to which disclosure would not be required under Item 404(a) of Regulation S-K promulgated pursuant to the Securities Act ( **Regulation S-K** )), does not possess an interest in any other transaction for which disclosure would be required under Item 404(a) of Regulation S-K, and is not engaged in a business relationship for which disclosure would be required pursuant to Item 404(b) of Regulation S-K; or (ii) is otherwise considered a non-employee director for purposes of Rule 16b-3.
- (r) **Employee** means any person employed by the Company or an Affiliate. However, service solely as a Director, or payment of a fee for such services, shall not cause a Director to be considered an Employee for purposes of the Plan.
- (s) **Entity** means a corporation, partnership, limited liability company or other entity.
- (t) **Exchange Act** means the Securities Exchange Act of 1934, as amended.
- (u) **Exchange Act Person** means any natural person, Entity or group (within the meaning of Section 13(d) or 14(d) of the Exchange Act), except that Exchange Act Person shall not include (i) the Company or any Subsidiary of the Company, (ii) any employee benefit plan of the Company or any Subsidiary of the Company or any trustee or other fiduciary holding securities under an employee benefit plan of the Company or any Subsidiary of the Company, (iii) an underwriter temporarily holding securities pursuant to an offering of such securities, (iv) an Entity Owned, directly or indirectly, by the stockholders of the Company in substantially the same proportions as their Ownership of stock of the Company; or (v) any natural person, Entity or group (within the meaning of Section 13(d) or 14(d) of the Exchange Act) that, as of the Effective Date of the Plan, as set forth in Section 13, is the Owner, directly or indirectly, of securities of the Company representing forty percent (40%) or more of the combined voting power of the Company's then outstanding securities.
- (v) **Fair Market Value** means, as of any date, the value of the Common Stock determined as follows:
- (i) If the Common Stock is listed on any established stock exchange or traded on the Nasdaq National Market or the Nasdaq SmallCap Market, the Fair Market Value of a share of Common Stock shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such exchange or market (or the exchange or market with the greatest volume of trading in the Common Stock) on the date of determination, as reported in *The Wall Street Journal* or such other source as the Board deems reliable. Unless otherwise provided by the Board, if there is no closing sales price (or closing bid if no sales were reported) for the Common Stock on the date of determination, then the Fair Market Value shall be the closing selling price (or closing bid if no sales were reported) on the last preceding date for which such quotation exists.
- (ii) In the absence of such markets for the Common Stock, the Fair Market Value shall be determined by the Board in good faith.
- (w) **Non-Employee Director** means a Director who is not an Employee.
- (x) **Nonstatutory Stock Option** means an Option not intended to qualify as an incentive stock option within the meaning of Section 422 of the Code and the regulations promulgated thereunder.
- (y) **Option** means a Nonstatutory Stock Option to purchase shares of Common Stock granted pursuant to the Plan.
- (z) **Option Agreement** means a written agreement between the Company and an Optionholder evidencing the terms and conditions of an Option grant. Each Option Agreement shall be subject to the terms and conditions of the Plan.

**(aa) Optionholder** means a person to whom an Option is granted pursuant to the Plan or, if permitted under the terms of this Plan, such other person who holds an outstanding Option.

**(bb) Other Stock Award** means an award based in whole or in part by reference to the Common Stock which is granted pursuant to the terms and conditions of Section 7(e).

**(cc) Other Stock Award Agreement** means a written agreement between the Company and a holder of an Other Stock Award evidencing the terms and conditions of an Other Stock Award grant. Each Other Stock Award Agreement shall be subject to the terms and conditions of the Plan.

**(dd) Own, Owned, Owner, Ownership** A person or Entity shall be deemed to Own, to have Owned, to be the Owner of, or to have acquired Ownership of securities if such person or Entity, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares voting power, which includes the power to vote or to direct the voting, with respect to such securities.

**(ee) Participant** means a person to whom a Stock Award is granted pursuant to the Plan or, if applicable, such other person who holds an outstanding Stock Award.

**(ff) Plan** means this Hollis-Eden Pharmaceuticals, Inc. 2005 Non-Employee Directors Equity Incentive Plan.

**(gg) Restricted Stock Award** means an award of shares of Common Stock which is granted pursuant to the terms and conditions of Section 7(b).

**(hh) Restricted Stock Award Agreement** means a written agreement between the Company and a holder of a Restricted Stock Award evidencing the terms and conditions of a Restricted Stock Award grant. Each Restricted Stock Award Agreement shall be subject to the terms and conditions of the Plan.

**(ii) Restricted Stock Unit Award** means a right to receive shares of Common Stock which is granted pursuant to the terms and conditions of Section 7(c).

**(jj) Restricted Stock Unit Award Agreement** means a written agreement between the Company and a holder of a Restricted Stock Unit Award evidencing the terms and conditions of a Restricted Stock Unit Award grant. Each Restricted Stock Unit Award Agreement shall be subject to the terms and conditions of the Plan.

**(kk) Rule 16b-3** means Rule 16b-3 promulgated under the Exchange Act or any successor to Rule 16b-3, as in effect from time to time.

**(ll) Securities Act** means the Securities Act of 1933, as amended.

**(mm) Stock Appreciation Right** means a right to receive the appreciation on Common Stock that is granted pursuant to the terms and conditions of Section 7(d).

**(nn) Stock Appreciation Right Agreement** means a written agreement between the Company and a holder of a Stock Appreciation Right evidencing the terms and conditions of a Stock Appreciation Right grant. Each Stock Appreciation Right Agreement shall be subject to the terms and conditions of the Plan.

**(oo) Stock Award** means any right granted under the Plan, including a Nonstatutory Stock Option, a Stock Purchase Award, Restricted Stock Award, a Stock Appreciation Right, a Restricted Stock Unit Award, or any Other Stock Award.

**(pp) Stock Award Agreement** means a written agreement between the Company and a Participant evidencing the terms and conditions of a Stock Award grant. Each Stock Award Agreement shall be subject to the terms and conditions of the Plan.

**(qq) Stock Purchase Award** means an award of shares of Common Stock which is granted pursuant to the terms and conditions of Section 7(a).

**(rr) Stock Purchase Award Agreement** means a written agreement between the Company and a holder of a Stock Purchase Award evidencing the terms and conditions of a Stock Purchase Award grant. Each Stock Purchase Award Agreement shall be subject to the terms and conditions of the Plan.

**(ss) Subsidiary** means, with respect to the Company, (i) any corporation of which more than fifty percent (50%) of the outstanding capital stock having ordinary voting power to elect a majority of the board of directors of such corporation (irrespective of whether, at the time, stock of any other class or classes of such corporation shall have or might have voting power by reason of the happening of any contingency) is at the time, directly or indirectly, Owned by the Company, and (ii) any partnership in which the Company has a direct or indirect interest (whether in the form of voting or participation in profits or capital contribution) of more than fifty percent (50%).

### 3. ADMINISTRATION.

**(a) Administration by Board.** The Board shall administer the Plan unless and until the Board delegates administration of the Plan to a Committee or Committees, as provided in Section 3(c).

**(b) Powers of Board.** The Board shall have the power, subject to, and within the limitations of, the express provisions of the Plan:

**(i)** To determine from time to time (A) which of the persons eligible under the Plan shall be granted Stock Awards; (B) when and how each Stock Award shall be granted; (C) what type or combination of types of Stock Award shall be granted; (D) the provisions of each Stock Award granted (which need not be identical), including the time or times when a person shall be permitted to receive Common Stock pursuant to a Stock Award; and (E) the number of shares of Common Stock with respect to which a Stock Award shall be granted to each such person.

**(ii)** To construe and interpret the Plan and Stock Awards granted under it, and to establish, amend and revoke rules and regulations for its administration. The Board, in the exercise of this power, may correct any defect, omission or inconsistency in the Plan or in any Stock Award Agreement, in a manner and to the extent it shall deem necessary or expedient to make the Plan or Stock Award Agreement fully effective.

**(iii)** To settle all controversies regarding the Plan and Stock Awards granted under it.

**(iv)** To accelerate the time at which a Stock Award may first be exercised or the time during which an Award or any part thereof will vest in accordance with the Plan, notwithstanding the provisions in the Award stating the time at which it may first be exercised or the time during which it will vest.

**(v)** To suspend or terminate the Plan at any time. Suspension or termination of the Plan shall not impair rights and obligations under any Stock Award granted while the Plan is in effect except with the written consent of the affected Participant.

**(vi)** To amend the Plan, subject to the limitations, if any, of applicable law. However, except as provided in Section 11(a) relating to Capitalization Adjustments, no amendment shall be effective unless approved by the stockholders of the Company to the extent stockholder approval is necessary to satisfy applicable law or applicable exchange listing requirements. Rights under any Award granted before amendment of the Plan shall not be impaired by any amendment of the Plan unless (i) the Company requests the consent of the affected Participant, and (ii) such Participant consents in writing.

**(vii)** To submit any amendment to the Plan for stockholder approval, including, but not limited to, amendments to the Plan intended to satisfy the requirements of Section 162(m) of the Code and the regulations thereunder regarding the exclusion of performance-based compensation from the limit on corporate deductibility of compensation paid to Covered Employees.

(viii) To amend the Plan in any respect the Board deems necessary or advisable to provide eligible Employees with the maximum benefits provided or to be provided under the provisions of the Code and the regulations promulgated thereunder relating to Incentive Stock Options or to bring the Plan or Incentive Stock Options granted under it into compliance therewith.

(ix) To amend the terms of any one or more Awards, including, but not limited to, amendments to provide terms more favorable than previously provided in the Award Agreement, subject to any specified limits in the Plan that are not subject to Board discretion; *provided, however*, that the rights under any Award shall not be impaired by any such amendment unless (i) the Company requests the consent of the affected Participant, and (ii) such Participant consents in writing.

(x) Generally, to exercise such powers and to perform such acts as the Board deems necessary or expedient to promote the best interests of the Company and that are not in conflict with the provisions of the Plan or Stock Awards.

**(c) Delegation to Committee.**

**(i) General.** The Board may delegate some or all of the administration of the Plan to a Committee or Committees. If administration of the Plan is delegated to a Committee, the Committee shall have, in connection with the administration of the Plan, the powers theretofore possessed by the Board that have been delegated to the Committee, including the power to delegate to a subcommittee of the Committee any of the administrative powers the Committee is authorized to exercise (and references in this Plan to the Board shall thereafter be to the Committee or subcommittee), subject, however, to such resolutions, not inconsistent with the provisions of the Plan, as may be adopted from time to time by the Board. The Board may retain the authority to concurrently administer the Plan with the Committee and may, at any time, revert in the Board some or all of the powers previously delegated.

**(ii) Rule 16b-3 Compliance.** In the sole discretion of the Board, the Committee may consist solely of two or more Eligible Committee Directors, in accordance with Rule 16b-3.

**(d) Effect of Board's Decision.** All determinations, interpretations and constructions made by the Board in good faith shall not be subject to review by any person and shall be final, binding and conclusive on all persons.

**4. SHARES SUBJECT TO THE PLAN.**

(a) Subject to the provisions of Section 11(a) relating to Capitalization Adjustments, the number of shares of Common Stock that may be issued pursuant to Stock Awards shall not exceed, in the aggregate, three hundred thousand (300,000) shares of Common Stock.

**(b) Reversion of Shares to the Share Reserve.** If any (i) Stock Award shall for any reason expire or otherwise terminate, in whole or in part, without having been exercised in full, (ii) shares of Common Stock issued to a Participant pursuant to a Stock Award are forfeited to or repurchased by the Company, including any repurchase or forfeiture caused by the failure to meet a contingency or condition required for the vesting of such shares, or (iii) Stock Award is settled in cash, then the shares of Common Stock not issued under such Stock Award, or forfeited to or repurchased by the Company, shall revert to and again become available for issuance under the Plan. If any shares subject to a Stock Award are not delivered to a Participant because the Stock Award is exercised through a reduction of shares subject to the Stock Award (*i.e.*, net exercised), the number of shares that are not delivered to the Participant shall remain available for issuance under the Plan. If any shares subject to a Stock Award are not delivered to a Participant because such shares are withheld in satisfaction of the withholding of taxes incurred in connection with the exercise of an Option, Stock Appreciation Right, or the issuance of shares under a Stock Purchase Award, Restricted Stock Award, or Restricted Stock Unit Award, the number of shares that are not delivered to the Participant shall remain available for subsequent issuance under the Plan. If the exercise price of any Stock Award is satisfied by tendering shares of Common Stock held by the Participant (either by actual delivery or attestation), then the number of shares so tendered shall remain available for subsequent issuance under the Plan.

(c) **Source of Shares.** The stock issuable under the Plan shall be shares of authorized but unissued or reacquired Common Stock, including shares repurchased by the Company.

**5. ELIGIBILITY.**

Only Non-Employee Directors may be granted Stock Awards under the Plan.

**6. OPTION PROVISIONS.**

Each Option shall be in such form and shall contain such terms and conditions as required by the Plan. Each Option shall contain such additional terms and conditions, not inconsistent with the Plan, as the Board shall deem appropriate. Each Option shall include (through incorporation of provisions hereof by reference in the Option or otherwise) the substance of each of the following provisions:

(a) **Term.** No Option shall be exercisable after the expiration of ten (10) years from the date of its grant.

(b) **Exercise Price.** The exercise price of each Option shall be not less than one hundred percent (100%) of the Fair Market Value of the Common Stock subject to the Option on the date the Option is granted.

(c) **Consideration.** The purchase price of Common Stock acquired pursuant to the exercise of an Option shall be paid, to the extent permitted by applicable law and as determined by the Board in its sole discretion, by any combination of the methods of payment set forth below. The Board shall have the authority to grant Options that do not permit all of the following methods of payment (or otherwise restrict the ability to use certain methods) and to grant Options that require the consent of the Company to utilize a particular method of payment. The methods of payment permitted by this Section 6(c) are:

(i) by cash or check;

(ii) bank draft or money order payable to the Company;

(iii) pursuant to a program developed under Regulation T as promulgated by the Federal Reserve Board that, prior to the issuance of Common Stock, results in either the receipt of cash (or check) by the Company or the receipt of irrevocable instructions to pay the aggregate exercise price to the Company from the sales proceeds;

(iv) by delivery to the Company (either by actual delivery or attestation) of shares of Common Stock;

(v) by a net exercise arrangement pursuant to which the Company will reduce the number of shares of Common Stock issued upon exercise by the largest whole number of shares with a Fair Market Value that does not exceed the aggregate exercise price; *provided, however*, that the Company shall accept a cash or other payment from the Participant to the extent of any remaining balance of the aggregate exercise price not satisfied by such reduction in the number of whole shares; *provided, further*, that shares of Common Stock will no longer be outstanding under an Option and will not be exercisable thereafter to the extent that (A) shares are used to pay the exercise price pursuant to the net exercise, (B) shares are delivered to the Participant as a result of such exercise, and (C) shares are withheld to satisfy tax withholding obligations; or

(vi) in any other form of legal consideration that may be acceptable to the Board; *provided, however*, that such form of consideration may not include deferred payment through the use of a promissory note.

(d) **Transferability of Options.** The Board may, in its sole discretion, impose such limitations on the transferability of Options as the Board shall determine. In the absence of such a determination by the Board to the contrary, the following restrictions on the transferability of Options shall apply:

(i) **Restrictions on Transfer.** An Option shall not be transferable except by will or by the laws of descent and distribution and shall be exercisable during the lifetime of the Optionholder only by the Optionholder; provided, however, that the Board may, in its sole discretion, permit transfer of the Option upon the Optionholder's request, provided that such transfer is in compliance with applicable tax and securities laws.

**(ii) Domestic Relations Orders.** Notwithstanding the foregoing, an Option may be transferred pursuant to a domestic relations order.

**(iii) Beneficiary Designation.** Notwithstanding the foregoing, the Optionholder may, by delivering written notice to the Company, in a form provided by or otherwise satisfactory to the Company, designate a third party who, in the event of the death of the Optionholder, shall thereafter be entitled to exercise the Option.

**(e) Vesting Generally.** The total number of shares of Common Stock subject to an Option may vest and therefore become exercisable in periodic installments that may or may not be equal. The Option may be subject to such other terms and conditions on the time or times when it may or may not be exercised as the Board may deem appropriate. The vesting provisions of individual Options may vary. The provisions of this Section 6(e) are subject to any Option provisions governing the minimum number of shares of Common Stock as to which an Option may be exercised.

**(f) Termination of Continuous Service.** In the event that an Optionholder's Continuous Service terminates (other than for Cause or upon the Optionholder's death or Disability or as of, or within twelve (12) months following a Change in Control), the Optionholder may exercise his or her Option (to the extent that the Optionholder was entitled to exercise such Option as of the date of termination of Continuous Service) but only within such period of time ending on the earlier of (i) the date three (3) months following the termination of the Optionholder's Continuous Service (or such longer or shorter period specified in the Option Agreement), or (ii) the expiration of the term of the Option as set forth in the Option Agreement. If, after termination of Continuous Service, the Optionholder does not exercise his or her Option within the time specified herein or in the Option Agreement (as applicable), the Option shall terminate.

**(g) Extension of Termination Date.** An Optionholder's Option Agreement may provide that if the exercise of the Option following the termination of the Optionholder's Continuous Service (other than for Cause or upon the Optionholder's death or Disability or upon a Change in Control) would be prohibited at any time solely because the issuance of shares of Common Stock would violate the registration requirements under the Securities Act, then the Option shall terminate on the earlier of (i) the expiration of a period of three (3) months after the termination of the Optionholder's Continuous Service during which the exercise of the Option would not be in violation of such registration requirements, or (ii) the expiration of the term of the Option as set forth in the Option Agreement.

**(h) Disability of Optionholder.** In the event that an Optionholder's Continuous Service terminates as a result of the Optionholder's Disability, the Optionholder may exercise his or her Option (to the extent that the Optionholder was entitled to exercise such Option as of the date of termination of Continuous Service), but only within such period of time ending on the earlier of (i) the date twelve (12) months following such termination of Continuous Service (or such longer or shorter period specified in the Option Agreement), or (ii) the expiration of the term of the Option as set forth in the Option Agreement. If, after termination of Continuous Service, the Optionholder does not exercise his or her Option within the time specified herein or in the Option Agreement (as applicable), the Option shall terminate.

**(i) Death of Optionholder.** In the event that (i) an Optionholder's Continuous Service terminates as a result of the Optionholder's death, or (ii) the Optionholder dies within the period (if any) specified in the Option Agreement after the termination of the Optionholder's Continuous Service for a reason other than death, then the Option may be exercised (to the extent the Optionholder was entitled to exercise such Option as of the date of death) by the Optionholder's estate, by a person who acquired the right to exercise the Option by bequest or inheritance or by a person designated to exercise the option upon the Optionholder's death, but only within the period ending on the earlier of (i) the date eighteen (18) months following the date of death (or such longer or shorter period specified in the Option Agreement), or (ii) the expiration of the term of such Option as set forth in the Option Agreement. If, after the Optionholder's death, the Option is not exercised within the time specified herein or in the Option Agreement (as applicable), the Option shall terminate.

**(j) Termination for Cause.** Except as explicitly provided otherwise in an Optionholder's Option Agreement, in the event that an Optionholder's Continuous Service is terminated for Cause, the Option shall terminate upon the termination date of such Optionholder's Continuous Service, and the Optionholder shall be prohibited from exercising his or her Option from and after the time of such termination of Continuous Service.

**(k) Termination Upon or Following a Change in Control.** In the event that an Optionholder's Continuous Service terminates as of, or within twelve (12) months following a Change in Control, the Optionholder may exercise his or her Option (to the extent that the Optionholder was entitled to exercise such Option as of the date of termination of Continuous Service) within such period of time ending on the earlier of (i) the date twelve (12) months following the effective date of the Change in Control (or such longer or shorter period specified in the Option Agreement), or (ii) the expiration of the term of the Option as set forth in the Option Agreement. If, after termination of Continuous Service, the Optionholder does not exercise his or her Option within the time specified herein or in the Option Agreement (as applicable), the Option shall terminate.

#### **7. PROVISIONS OF STOCK AWARDS OTHER THAN OPTIONS.**

**(a) Stock Purchase Awards.** Each Stock Purchase Award Agreement shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. To the extent consistent with the Company's Bylaws, at the Board's election, shares of Common Stock may be (x) held in book entry form subject to the Company's instructions until any restrictions relating to the Stock Purchase Award lapse; or (y) evidenced by a certificate, which certificate shall be held in such form and manner as determined by the Board. The terms and conditions of Stock Purchase Award Agreements may change from time to time, and the terms and conditions of separate Stock Purchase Award Agreements need not be identical, *provided, however*, that each Stock Purchase Award Agreement shall include (through incorporation of the provisions hereof by reference in the Agreement or otherwise) the substance of each of the following provisions:

**(i) Purchase Price.** At the time of the grant of a Stock Purchase Award, the Board will determine the price to be paid by the Participant for each share subject to the Stock Purchase Award. To the extent required by applicable law, the price to be paid by the Participant for each share of the Stock Purchase Award will not be less than the par value of a share of Common Stock.

**(ii) Consideration.** At the time of the grant of a Stock Purchase Award, the Board will determine the consideration permissible for the payment of the purchase price of the Stock Purchase Award. The purchase price of Common Stock acquired pursuant to the Stock Purchase Award shall be paid either: (A) in cash or by check at the time of purchase, (B) by past or future services actually rendered to the Company or an Affiliate, or (C) in any other form of legal consideration that may be acceptable to the Board in its sole discretion and permissible under applicable law.

**(iii) Vesting.** Shares of Common Stock acquired under a Stock Purchase Award may be subject to a share repurchase right or option in favor of the Company in accordance with a vesting schedule to be determined by the Board.

**(iv) Termination of Participant's Continuous Service.** In the event that a Participant's Continuous Service terminates, the Company shall have the right, but not the obligation, to repurchase or otherwise reacquire, any or all of the shares of Common Stock held by the Participant that have not vested as of the date of termination under the terms of the Stock Purchase Award Agreement. At the Board's election, the price paid for all shares of Common Stock so repurchased or reacquired by the Company may be at the lesser of: (A) the Fair Market Value on the relevant date, or (B) the Participant's original cost for such shares. The Company shall not be required to exercise its repurchase or reacquisition option until at least six (6) months (or such longer or shorter period of time necessary to avoid a charge to earnings for financial accounting purposes) have elapsed following the Participant's purchase of the shares of Common Stock acquired pursuant to the Stock Purchase Award unless otherwise determined by the Board or provided in the Stock Purchase Award Agreement.



**(v) Transferability.** Rights to purchase or receive shares of Common Stock granted under a Stock Purchase Award shall be transferable by the Participant only upon such terms and conditions as are set forth in the Stock Purchase Award Agreement, as the Board shall determine in its sole discretion, and so long as Common Stock awarded under the Stock Purchase Award remains subject to the terms of the Stock Purchase Award Agreement.

**(b) Restricted Stock Awards.** Each Restricted Stock Award Agreement shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. To the extent consistent with the Company's Bylaws, at the Board's election, shares of Common Stock may be (x) held in book entry form subject to the Company's instructions until any restrictions relating to the Restricted Stock Award lapse; or (y) evidenced by a certificate, which certificate shall be held in such form and manner as determined by the Board. The terms and conditions of Restricted Stock Award Agreements may change from time to time, and the terms and conditions of separate Restricted Stock Award Agreements need not be identical, *provided, however*, that each Restricted Stock Award Agreement shall include (through incorporation of provisions hereof by reference in the agreement or otherwise) the substance of each of the following provisions:

**(i) Consideration.** A Restricted Stock Award may be awarded in consideration for (A) past or future services actually rendered to the Company or an Affiliate, or (B) any other form of legal consideration that may be acceptable to the Board in its sole discretion and permissible under applicable law.

**(ii) Vesting.** Shares of Common Stock awarded under the Restricted Stock Award Agreement may be subject to forfeiture to the Company in accordance with a vesting schedule to be determined by the Board.

**(iii) Termination of Participant's Continuous Service.** In the event a Participant's Continuous Service terminates, the Company may receive via a forfeiture condition, any or all of the shares of Common Stock held by the Participant which have not vested as of the date of termination of Continuous Service under the terms of the Restricted Stock Award Agreement.

**(iv) Transferability.** Rights to acquire shares of Common Stock under the Restricted Stock Award Agreement shall be transferable by the Participant only upon such terms and conditions as are set forth in the Restricted Stock Award Agreement, as the Board shall determine in its sole discretion, so long as Common Stock awarded under the Restricted Stock Award Agreement remains subject to the terms of the Restricted Stock Award Agreement.

**(c) Restricted Stock Unit Awards.** Each Restricted Stock Unit Award Agreement shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. The terms and conditions of Restricted Stock Unit Award Agreements may change from time to time, and the terms and conditions of separate Restricted Stock Unit Award Agreements need not be identical, *provided, however*, that each Restricted Stock Unit Award Agreement shall include (through incorporation of the provisions hereof by reference in the Agreement or otherwise) the substance of each of the following provisions:

**(i) Consideration.** At the time of grant of a Restricted Stock Unit Award, the Board will determine the consideration, if any, to be paid by the Participant upon delivery of each share of Common Stock subject to the Restricted Stock Unit Award. The consideration to be paid (if any) by the Participant for each share of Common Stock subject to a Restricted Stock Unit Award may be paid in any form of legal consideration that may be acceptable to the Board in its sole discretion and permissible under applicable law.

**(ii) Vesting.** At the time of the grant of a Restricted Stock Unit Award, the Board may impose such restrictions or conditions to the vesting of the Restricted Stock Unit Award as it, in its sole discretion, deems appropriate.

**(iii) Payment.** A Restricted Stock Unit Award may be settled by the delivery of shares of Common Stock, their cash equivalent, any combination thereof or in any other form of consideration, as determined by the Board and contained in the Restricted Stock Unit Award Agreement.

**(iv) Additional Restrictions.** At the time of the grant of a Restricted Stock Unit Award, the Board, as it deems appropriate, may impose such restrictions or conditions that delay the delivery of the shares of Common Stock (or their cash equivalent) subject to a Restricted Stock Unit Award after the vesting of such Restricted Stock Unit Award.

**(v) Dividend Equivalents.** Dividend equivalents may be credited in respect of shares of Common Stock covered by a Restricted Stock Unit Award, as determined by the Board and contained in the Restricted Stock Unit Award Agreement. At the sole discretion of the Board, such dividend equivalents may be converted into additional shares of Common Stock covered by the Restricted Stock Unit Award in such manner as determined by the Board. Any additional shares covered by the Restricted Stock Unit Award credited by reason of such dividend equivalents will be subject to all the terms and conditions of the underlying Restricted Stock Unit Award Agreement to which they relate.

**(vi) Termination of Participant's Continuous Service.** Except as otherwise provided in the applicable Restricted Stock Unit Award Agreement, such portion of the Restricted Stock Unit Award that has not vested will be forfeited upon the Participant's termination of Continuous Service.

**(vii) Compliance with Section 409A of the Code.** Notwithstanding anything to the contrary set forth herein, any Restricted Stock Unit Award granted under the Plan that is not exempt from the requirements of Section 409A of the Code shall contain such provisions so that such Restricted Stock Unit Award will comply with the requirements of Section 409A of the Code. Such restrictions, if any, shall be determined by the Board and contained in the Restricted Stock Unit Award Agreement evidencing such Restricted Stock Unit Award. For example, such restrictions may include, without limitation, a requirement that any Common Stock that is to be issued in a year following the year in which the Restricted Stock Unit Award vests must be issued in accordance with a fixed pre-determined schedule.

**(d) Stock Appreciation Rights.** Each Stock Appreciation Right Agreement shall be in such form and shall contain such terms and conditions as the Board shall deem appropriate. Stock Appreciation Rights may be granted as stand-alone Stock Awards or in tandem with other Stock Awards. The terms and conditions of Stock Appreciation Right Agreements may change from time to time, and the terms and conditions of separate Stock Appreciation Right Agreements need not be identical; *provided, however*, that each Stock Appreciation Right Agreement shall include (through incorporation of the provisions hereof by reference in the Agreement or otherwise) the substance of each of the following provisions:

**(i) Term.** No Stock Appreciation Right shall be exercisable after the expiration of ten (10) years from the date of its grant.

**(ii) Strike Price.** Each Stock Appreciation Right will be denominated in shares of Common Stock equivalents. The strike price of each Stock Appreciation Right granted as a stand-alone or tandem Stock Award shall not be less than one hundred percent (100%) of the Fair Market Value of the Common Stock equivalents subject to the Stock Appreciation Right on the date of grant.

**(iii) Calculation of Appreciation.** The appreciation distribution payable on the exercise of a Stock Appreciation Right will be not greater than an amount equal to the excess of (A) the aggregate Fair Market Value (on the date of the exercise of the Stock Appreciation Right) of a number of shares of Common Stock equal to the number of share of Common Stock equivalents in which the Participant is vested under such Stock Appreciation Right, and with respect to which the Participant is exercising the Stock Appreciation Right on such date, over (B) the strike price that will be determined by the Board at the time of grant of the Stock Appreciation Right.

**(iv) Vesting.** At the time of the grant of a Stock Appreciation Right, the Board may impose such restrictions or conditions to the vesting of such Stock Appreciation Right as it, in its sole discretion, deems appropriate.

**(v) Exercise.** To exercise any outstanding Stock Appreciation Right, the Participant must provide written notice of exercise to the Company in compliance with the provisions of the Stock Appreciation Right Agreement evidencing such Stock Appreciation Right.

**(vi) Payment.** The appreciation distribution in respect to a Stock Appreciation Right may be paid in Common Stock, in cash, in any combination of the two or in any other form of consideration, as determined by the Board and contained in the Stock Appreciation Right Agreement evidencing such Stock Appreciation Right.

**(vii) Termination of Continuous Service.** In the event that a Participant's Continuous Service terminates (other than for Cause or as of or within twelve (12) months following a Change in Control), the Participant may exercise his or her Stock Appreciation Right (to the extent that the Participant was entitled to exercise such Stock Appreciation Right as of the date of termination) but only within such period of time ending on the earlier of (A) the date three (3) months following the termination of the Participant's Continuous Service (or such longer or shorter period specified in the Stock Appreciation Right Agreement), or (B) the expiration of the term of the Stock Appreciation Right as set forth in the Stock Appreciation Right Agreement. If, after termination, the Participant does not exercise his or her Stock Appreciation Right within the time specified herein or in the Stock Appreciation Right Agreement (as applicable), the Stock Appreciation Right shall terminate.

**(viii) Termination for Cause.** Except as explicitly provided otherwise in a Participant's Stock Appreciation Right Agreement, in the event that a Participant's Continuous Service is terminated for Cause, the Stock Appreciation Right shall terminate upon the termination date of such Participant's Continuous Service, and the Participant shall be prohibited from exercising his or her Stock Appreciation Right from and after the time of such termination of Continuous Service.

**(ix) Termination Upon Change in Control.** In the event that a Participant's Continuous Service terminates as of, or within twelve (12) months following a Change in Control, the Participant may exercise his or her Stock Appreciation Right (to the extent that the Participant was entitled to exercise such Stock Appreciation Right as of the date of termination of Continuous Service) within such period of time ending on the earlier of (i) the date twelve (12) months following the effective date of the Change in Control (or such longer or shorter period specified in the Stock Appreciation Right Agreement), or (ii) the expiration of the term of the Stock Appreciation Right as set forth in the Stock Appreciation Right Agreement. If, after termination of Continuous Service, the Participant does not exercise his or her Stock Appreciation Right within the time specified herein or in the Stock Appreciation Right Agreement (as applicable), the Stock Appreciation Right shall terminate.

**(x) Compliance with Section 409A of the Code.** Notwithstanding anything to the contrary set forth herein, any Stock Appreciation Rights granted under the Plan that are not exempt from the requirements of Section 409A of the Code shall contain such provisions so that such Stock Appreciation Rights will comply with the requirements of Section 409A of the Code. Such restrictions, if any, shall be determined by the Board and contained in the Stock Appreciation Right Agreement evidencing such Stock Appreciation Right. For example, such restrictions may include, without limitation, a requirement that a Stock Appreciation Right that is to be paid wholly or partly in cash must be exercised and paid in accordance with a fixed pre-determined schedule.

**(e) Other Stock Awards.** Other forms of Stock Awards valued in whole or in part by reference to, or otherwise based on, Common Stock may be granted either alone or in addition to Stock Awards provided for under Section 6 and the preceding provisions of this Section 7. Subject to the provisions of the Plan, the Board shall have sole and complete authority to determine the persons to whom and the time or times at which such Other Stock Awards will be granted, the number of shares of Common Stock (or the cash equivalent thereof) to be granted pursuant to such Other Stock Awards and all other terms and conditions of such Other Stock Awards.

## **8. COVENANTS OF THE COMPANY.**

**(a) Availability of Shares.** During the terms of the Stock Awards, the Company shall keep available at all times the number of shares of Common Stock required to satisfy such Stock Awards.

**(b) Securities Law Compliance.** The Company shall seek to obtain from each regulatory commission or agency having jurisdiction over the Plan such authority as may be required to grant Stock Awards and to issue and sell shares of Common Stock upon exercise of the Stock Awards; *provided, however*, that this undertaking shall not require the Company to register under the Securities Act the Plan, any Stock Award or any Common Stock issued or issuable pursuant to any such Stock Award. If, after reasonable efforts, the Company is unable to obtain from any such regulatory commission or agency the authority that counsel for the Company deems necessary for the lawful issuance and sale of Common Stock under the Plan, the Company shall be relieved from any liability for failure to issue and sell Common Stock upon exercise of such Stock Awards unless and until such authority is obtained.

**9. USE OF PROCEEDS FROM SALES OF COMMON STOCK.**

Proceeds from the sale of shares of Common Stock pursuant to Stock Awards shall constitute general funds of the Company.

**10. MISCELLANEOUS.**

**(a) Corporate Action Constituting Grant of Stock Awards.** Corporate action constituting an offer by the Company of Common Stock to any Participant under the terms of a Stock Award shall be deemed completed as of the date of such corporate action, unless otherwise determined by the Board, regardless of when the instrument, certificate, or letter evidencing the Stock Award is actually received or accepted by the Participant.

**(b) Stockholder Rights.** No Participant shall be deemed to be the holder of, or to have any of the rights of a holder with respect to, any shares of Common Stock subject to such Stock Award unless and until such Participant has satisfied all requirements for exercise of the Stock Award pursuant to its terms.

**(c) No Service Rights.** Nothing in the Plan, any Stock Award Agreement or other instrument executed thereunder or in connection with any Stock Award granted pursuant to the Plan shall confer upon any Participant any right to continue to serve the Company or an Affiliate as a Non-Employee Director or shall affect the right of the Company or an Affiliate to terminate the service of a Director pursuant to the Bylaws of the Company or an Affiliate, and any applicable provisions of the corporate law of the state in which the Company or the Affiliate is incorporated, as the case may be.

**(d) Investment Assurances.** The Company may require a Participant, as a condition of exercising or acquiring Common Stock under any Stock Award, (i) to give written assurances satisfactory to the Company as to the Participant's knowledge and experience in financial and business matters and/or to employ a purchaser representative reasonably satisfactory to the Company who is knowledgeable and experienced in financial and business matters and that he or she is capable of evaluating, alone or together with the purchaser representative, the merits and risks of exercising the Stock Award; and (ii) to give written assurances satisfactory to the Company stating that the Participant is acquiring Common Stock subject to the Stock Award for the Participant's own account and not with any present intention of selling or otherwise distributing the Common Stock. The foregoing requirements, and any assurances given pursuant to such requirements, shall be inoperative if (x) the issuance of the shares upon the exercise or acquisition of Common Stock under the Stock Award has been registered under a then currently effective registration statement under the Securities Act, or (y) as to any particular requirement, a determination is made by counsel for the Company that such requirement need not be met in the circumstances under the then applicable securities laws. The Company may, upon advice of counsel to the Company, place legends on stock certificates issued under the Plan as such counsel deems necessary or appropriate in order to comply with applicable securities laws, including, but not limited to, legends restricting the transfer of the Common Stock.

**(e) Withholding Obligations.** To the extent provided by the terms of a Stock Award Agreement, the Company may, in its sole discretion, satisfy any federal, state or local tax withholding obligation relating to a

Stock Award by any of the following means (in addition to the Company's right to withhold from any compensation paid to the Participant by the Company) or by a combination of such means: (i) causing the Participant to tender a cash payment; (ii) withholding shares of Common Stock from the shares of Common Stock issued or otherwise issuable to the Participant in connection with the Stock Award; or (iii) by such other method as may be set forth in the Stock Award Agreement.

**(f) Electronic Delivery.** Any reference herein to a written agreement or document shall include any agreement or document delivered electronically or posted on the Company's intranet.

#### **11. ADJUSTMENTS UPON CHANGES IN COMMON STOCK; OTHER CORPORATE EVENTS.**

**(a) Capitalization Adjustments.** If any change is made in, or other events occur with respect to, the Common Stock subject to the Plan or subject to any Stock Award after the Effective Date without the receipt of consideration by the Company (through merger, consolidation, reorganization, recapitalization, reincorporation, stock dividend, dividend in property other than cash, stock split, liquidating dividend, combination of shares, exchange of shares, change in corporate structure or other transaction not involving the receipt of consideration by the Company (each a *Capitalization Adjustment*)), the Board shall appropriately adjust: (i) the class(es) and maximum number of securities subject to the Plan pursuant to Section 4(a), and (ii) the class(es) and number of securities and price per share of stock subject to outstanding Stock Awards. The Board shall make such adjustments, and its determination shall be final, binding and conclusive. (Notwithstanding the foregoing, the conversion of any convertible securities of the Company shall not be treated as a transaction without receipt of consideration by the Company.)

**(b) Dissolution or Liquidation.** In the event of a dissolution or liquidation of the Company, all outstanding Options and Stock Appreciation Rights shall terminate immediately prior to the completion of such dissolution or liquidation.

**(c) Corporate Transaction.** The following provisions shall apply to Stock Awards in the event of a Corporate Transaction unless otherwise provided in the instrument evidencing the Stock Award or any other written agreement between the Company or any Affiliate and the holder of the Stock Award or unless otherwise expressly provided by the Board at the time of grant of a Stock Award.

**(i) Stock Awards May Be Assumed.** In the event of a Corporate Transaction, any surviving corporation or acquiring corporation (or the surviving or acquiring corporation's parent company) may assume or continue any or all Stock Awards outstanding under the Plan or may substitute similar stock awards for Stock Awards outstanding under the Plan (including but not limited to, awards to acquire the same consideration paid to the stockholders of the Company pursuant to the Corporate Transaction), and any reacquisition or repurchase rights held by the Company in respect of Common Stock issued pursuant to Stock Awards may be assigned by the Company to the successor of the Company (or the successor's parent company, if any), in connection with such Corporate Transaction. A surviving corporation or acquiring corporation (or its parent) may choose to assume or continue only a portion of a Stock Award or substitute a similar stock award for only a portion of a Stock Award. The terms of any assumption, continuation or substitution shall be set by the Board in accordance with the provisions of Section 3.

**(ii) Stock Awards Held by Current Participants.** In the event of a Corporate Transaction in which the surviving corporation or acquiring corporation (or its parent company) does not assume or continue such outstanding Stock Awards or substitute similar stock awards for such outstanding Stock Awards, then with respect to Stock Awards that have not been assumed, continued or substituted and that are held by Participants whose Continuous Service has not terminated prior to the effective time of the Corporate Transaction (referred to as the *Current Participants*), the vesting of such Stock Awards (and, if applicable, the time at which such Stock Awards may be exercised) shall (contingent upon the effectiveness of the Corporate Transaction) be accelerated in full to a date prior to the effective time of such Corporate Transaction as the Board shall determine (or, if the Board shall not determine such a date, to the date that is

five (5) days prior to the effective time of the Corporate Transaction), and such Stock Awards shall terminate if not exercised (if applicable) at or prior to the effective time of the Corporate Transaction, and any reacquisition or repurchase rights held by the Company with respect to such Stock Awards shall lapse (contingent upon the effectiveness of the Corporate Transaction).

**(iii) Stock Awards Held by Persons other than Current Participants.** In the event of a Corporate Transaction in which the surviving corporation or acquiring corporation (or its parent company) does not assume or continue such outstanding Stock Awards or substitute similar stock awards for such outstanding Stock Awards, then with respect to Stock Awards that have not been assumed, continued or substituted and that are held by persons other than Current Participants, the vesting of such Stock Awards (and, if applicable, the time at which such Stock Award may be exercised) shall not be accelerated and such Stock Awards (other than a Stock Award consisting of vested and outstanding shares of Common Stock not subject to the Company's right of repurchase) shall terminate if not exercised (if applicable) prior to the effective time of the Corporate Transaction; *provided, however*, that any reacquisition or repurchase rights held by the Company with respect to such Stock Awards shall not terminate and may continue to be exercised notwithstanding the Corporate Transaction.

**(iv) Payment for Stock Awards in Lieu of Exercise.** Notwithstanding the foregoing, in the event a Stock Award will terminate if not exercised prior to the effective time of a Corporate Transaction, the Board may provide, in its sole discretion, that the holder of such Stock Award may not exercise such Stock Award but will receive a payment, in such form as may be determined by the Board, equal in value to the excess, if any, of (A) the value of the property the holder of the Stock Award would have received upon the exercise of the Stock Award, over (B) any exercise price payable by such holder in connection with such exercise.

**(d) Change in Control.** Notwithstanding anything to the contrary contained in Section 11(c) of the Plan, in the event that a Non-Employee Director is required to resign his or her position as a Non-Employee Director as a condition of a Change in Control, the outstanding Stock Awards of such Participant shall become fully vested and exercisable immediately prior to the effectiveness of such resignation (and contingent upon the effectiveness of the Change in Control). In addition, upon a Change in Control event described in Section 2(e)(i), 2(e)(ii), 2(e)(iii) or 2(e)(iv), each Stock Award held by a Participant whose Continuous Service has not terminated as of the date immediately prior to the effective date of such Change in Control shall automatically become fully vested (and any reacquisition or repurchase rights held by the Company with respect to the shares of Common Stock subject to such acceleration shall lapse in full, as appropriate) and, if applicable, each such Stock Award shall become immediately exercisable in full. In addition, a Stock Award may be subject to additional acceleration of vesting and exercisability upon or after a Change in Control described in Section 2(e)(v) as may be provided in the Stock Award Agreement for such Stock Award or as may be provided in any other written agreement between the Company or any Affiliate and the Participant, but in the absence of such provision, no such acceleration shall occur.

**(e) Parachute Payments.**

(i) If the acceleration of the vesting and exercisability of Stock Awards provided for in Sections 11(c) and 11(d), together with payments and other benefits of a Participant (collectively, the **Payment**) (i) constitute a parachute payment within the meaning of Section 280G of the Code, or any comparable successor provisions, and (ii) but for this Section 11(e) would be subject to the excise tax imposed by Section 4999 of the Code, or any comparable successor provisions (the **Excise Tax**), then such Payment shall be either (1) provided to such Participant in full, or (2) provided to such Participant as to such lesser extent that would result in no portion of such Payment being subject to the Excise Tax, whichever of the foregoing amounts, when taking into account applicable federal, state, local and foreign income and employment taxes, the Excise Tax, and any other applicable taxes, results in the receipt by such Participant, on an after-tax basis, of the greatest amount of the Payment, notwithstanding that all or some portion of the Payment may be subject to the Excise Tax.

(ii) The Company shall appoint a nationally recognized independent accounting firm (the **Accountant**) to make the determinations required hereunder, which accounting firm shall not then be serving as accountant or auditor for the individual, entity or group that effected the Change in Control. The Company shall bear all costs and expenses with respect to the determinations the Accountant may reasonably incur in connection with any calculations contemplated by this Section 11(e).

(iii) Unless the Company and such Participant otherwise agree in writing, any determination required under this Section 11(e) shall be made in writing in good faith by the Accountant. If a reduction in the Payment is to be made as provided above, reductions shall occur in the following order unless the Participant elects in writing a different order (*provided, however*, that such election shall be subject to Company approval if made on or after the date that triggers the Payment or a portion thereof): (A) reduction of cash payments; (B) cancellation of accelerated vesting of Options and other Stock Awards; and (C) reduction of other benefits paid to the Participant. If acceleration of vesting of Stock Awards is to be reduced, such acceleration of vesting shall be cancelled in the reverse order of date of grant of the Stock Awards (*i.e.*, the earliest granted Stock Award cancelled last) unless the Participant elects in writing a different order for cancellation.

(iv) For purposes of making the calculations required by this Section 11(e), the Accountant may make reasonable assumptions and approximations concerning applicable taxes and may rely on reasonable, good faith interpretations concerning the application of the Code and other applicable legal authority. The Company and the Participant shall furnish to the Accountant such information and documents as the Accountant may reasonably request in order to make such a determination.

(v) If, notwithstanding any reduction described above, the Internal Revenue Service (the **IRS**) determines that the Participant is liable for the Excise Tax as a result of the Payment, then the Participant shall be obligated to pay back to the Company, within thirty (30) days after a final IRS determination or, in the event that the Participant challenges the final IRS determination, a final judicial determination, a portion of the Payment (the **Repayment Amount**). The Repayment Amount with respect to the Payment shall be the smallest such amount, if any, as shall be required to be paid to the Company so that the Participant's net after-tax proceeds with respect to the Payment (after taking into account the payment of the Excise Tax and all other applicable taxes imposed on the Payment) shall be maximized. The Repayment Amount with respect to the Payment shall be zero if a Repayment Amount of more than zero would not result in the Participant's net after-tax proceeds with respect to the Payment being maximized. If the Excise Tax is not eliminated pursuant to this paragraph, the Optionholder shall pay the Excise Tax.

(vi) Notwithstanding any other provision of this Section 11(e), if (A) there is a reduction in the Payment as described above, (B) the IRS later determines that the Participant is liable for the Excise Tax, the payment of which would result in the maximization of the Participant's net after-tax proceeds of the Payment (calculated as if the Payment had not previously been reduced), and (C) the Participant the Excise Tax, then the Company shall pay or otherwise provide to the Participant that portion of the Payment that was reduced pursuant to this Section 11(e) contemporaneously or as soon as administratively possible after the Optionholder pays the Excise Tax so that the Participant's net after-tax proceeds with respect to the Payment are maximized.

(vii) If the Participant either (A) brings any action to enforce rights pursuant to this Section 11(e), or (B) defends any legal challenge to his or her rights under this Section 11(e), the Participant shall be entitled to recover attorneys' fees and costs incurred in connection with such action, regardless of the outcome of such action; *provided, however*, that if such action is commenced by the Participant, the court finds that the action was brought in good faith.

## 12. TERMINATION OR SUSPENSION OF THE PLAN.

(a) **Plan Term.** Unless sooner terminated by the Board pursuant to Section 3, the Plan shall automatically terminate on the day before the tenth (10th) anniversary of the date the Plan is adopted by the Board or approved by the stockholders of the Company, whichever is earlier. No Awards may be granted under the Plan while the Plan is suspended or after it is terminated.

**(b) No Impairment of Rights.** Termination of the Plan shall not impair rights and obligations under any Stock Award granted while the Plan is in effect except with the written consent of the affected Participant.

**13. EFFECTIVE DATE OF PLAN.**

This Plan shall become effective on the Effective Date.

**14. CHOICE OF LAW.**

The law of the State of California shall govern all questions concerning the construction, validity and interpretation of this Plan, without regard to such state's conflict of laws rules.



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**HOLLIS-EDEN PHARMACEUTICALS, INC.**

PROXY SOLICITED BY THE BOARD OF DIRECTORS

FOR THE ANNUAL MEETING OF STOCKHOLDERS TO BE HELD ON JUNE 9, 2006

The undersigned hereby appoints Richard B. Hollis, Daniel D. Burgess and Robert W. Weber, and each of them, as attorneys and proxies of the undersigned, with full power of substitution, to vote all of the shares of stock of Hollis-Eden Pharmaceuticals, Inc. (the Company) which the undersigned may be entitled to vote at the Annual Meeting of Stockholders of the Company to be held at The Hilton La Jolla Torrey Pines, 10950 North Torrey Pines Road, La Jolla, CA 92037, on Friday, June 9, 2006, at 2:00 p.m., local time, and at any and all continuations, adjournments or postponements thereof, with all powers that the undersigned would possess if personally present, upon and in respect of the following matters and in accordance with the following instructions, with discretionary authority as to any and all other matters that may properly come before the meeting.

**UNLESS A CONTRARY DIRECTION IS INDICATED, THIS PROXY WILL BE VOTED FOR ALL NOMINEES LISTED IN PROPOSAL 1 AND FOR PROPOSALS 2, 3 AND 4, AS MORE SPECIFICALLY DESCRIBED IN THE PROXY STATEMENT. IF SPECIFIC INSTRUCTIONS ARE INDICATED, THIS PROXY WILL BE VOTED IN ACCORDANCE THEREWITH.**

*(Continued on other side)*

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**Please Detach and Mail in the Envelope Provided**

A  Please mark your votes as in this example.

**MANAGEMENT RECOMMENDS A VOTE FOR THE NOMINEES FOR DIRECTOR LISTED BELOW**

**AND FOR PROPOSALS 2, 3 AND 4.**

Proposal 1. To elect two Class III directors to hold office until the 2009 Annual Meeting of Stockholders and until their successors are elected.

FOR all nominees listed at right (except as marked to the contrary below) " Nominees:

Richard B. Hollis

Salvatore J. Zizza

WITHHOLD AUTHORITY to vote for all nominees listed at right "

To withhold authority to vote for any nominee(s), write such nominee(s) name(s) below

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Proposal 2. To amend the Company's 2005 Equity Incentive Plan, as amended, to increase the aggregate number of shares of common stock authorized for issuance under such Plan by 500,000 shares.

FOR

AGAINST

ABSTAIN

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Proposal 3. To amend the Company's 2005 Non-Employee Directors' Equity Incentive Plan, as amended, to increase the aggregate number of shares of common stock authorized for issuance under such Plan by 150,000 shares.

