

ACURA PHARMACEUTICALS, INC  
Form DEF 14A  
April 02, 2008

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549**

**SCHEDULE 14A**

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

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

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

**ACURA PHARMACEUTICALS, INC.**

(Name of Registrant as Specified in Its Charter)

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

Payment of Filing Fee (Check the appropriate box):

x No fee required.  
 o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.  
(1) Title of each class of securities to which transaction applies:  
(2) Aggregate number of securities to which transaction applies:

(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):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

o Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement no.:

(3) Filing Party:

(4) Date Filed:

---

TABLE OF CONTENTS

**ACURA PHARMACEUTICALS, INC.  
616 N. North Court, Suite 120  
Palatine, Illinois 60067**

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

Notice is hereby given that the 2008 Annual Meeting of Shareholders (the Meeting ) of Acura Pharmaceuticals, Inc., a New York corporation, (the Company ), will be held at the Marriott Courtyard, 87 Glimcher Realty Way, Elizabeth, New Jersey 07201 on April 30, 2008 at 9:00 a.m., Eastern Time, for the purposes listed below:

1. To elect seven directors to the Board of Directors who shall serve until the 2009 Annual Meeting of Shareholders, or until their successors have been elected and qualified;
  2. To ratify the adoption of the Company's 2008 Stock Option Plan;
  3. To ratify the adoption of an amendment to the Company's 2005 Restricted Stock Unit Award Plan to increase the number of shares available for issuance thereunder by 500,000 shares;
  4. To ratify the appointment of BDO Seidman, LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2008; and
  5. To transact such other business as may properly come before the Meeting or any adjournment thereof.
- Only shareholders of record at the close of business on March 31, 2008 are entitled to notice of and to vote at the Meeting or any adjournment thereof.

For a period of 10 days prior to the Meeting, a shareholders list will be kept at the Company's administrative office and shall be available for inspection by shareholders during normal business hours. A shareholders list shall also be

present and available for inspection at the Meeting.

Your attention is directed to the accompanying Proxy Statement for the text of the resolutions to be proposed at the Meeting and further information regarding each proposal to be made.

SHAREHOLDERS UNABLE TO ATTEND THE MEETING ARE URGED TO COMPLETE, DATE AND SIGN THE ENCLOSED PROXY AND RETURN IT IN THE ENCLOSED ENVELOPE. IF YOU ATTEND THE MEETING, YOU MAY REVOKE YOUR PROXY AND VOTE IN PERSON IF YOU WISH.

Peter A. Clemens  
Senior Vice President,  
Chief Financial Officer and Secretary

April 2, 2008  
Palatine, Illinois

---

TABLE OF CONTENTS

**ACURA PHARMACEUTICALS, INC.**  
**616 N. North Court, Suite 120**  
**Palatine, Illinois 60067**

**PROXY STATEMENT**

**2008 ANNUAL MEETING OF SHAREHOLDERS**

This Proxy Statement is furnished in connection with the solicitation by the Board of Directors of ACURA PHARMACEUTICALS, INC. (the Company) of proxies in the accompanying form, to be voted at the 2008 Annual Meeting of Shareholders of the Company (the Meeting) to be held on April 30, 2008, and at any adjournment(s) thereof, for the purposes set forth in the accompanying Notice of Annual Meeting of Shareholders. This Proxy Statement and the form of proxy were first mailed to shareholders on or about April 2, 2008.

The close of business on March 31, 2008 has been fixed as the record date (the Record Date) for the determination of shareholders entitled to notice of and to vote at the Meeting. On the Record Date, our outstanding voting securities consisted of 42,706,466 shares of common stock, \$.01 par value per share (the Common Stock). Under the New York Business Corporation Law and our Restated Certificate of Incorporation and Bylaws, each stockholder will be entitled to one vote for each share of Common Stock held at the Record Date, for all matters, including the election of directors. The required quorum for the transaction of business at the Meeting is a majority of the votes eligible to be cast by holders of shares of Common Stock outstanding on the Record Date. Shares that are voted **FOR, AGAINST, WITHHELD** or **ABSTAIN** are treated as being present at the Meeting for the purposes of establishing a quorum and are also treated as shares entitled to vote at the Meeting (the Votes Cast) with respect to such matter. Abstentions will have the same effect as voting against a proposal. Broker non-votes will be counted for purposes of determining the presence or absence of a quorum for the transaction of business, but such non-votes will not be counted for purposes of determining the number of Votes Cast with respect to the particular proposal on which a broker has expressly not voted. Thus a broker non-vote will not effect the outcome of the voting on a proposal. Holders of Common Stock have no cumulative voting rights in the election of directors. Shareholders have no

appraisal rights with respect to any matter being voted upon.

TABLE OF CONTENTS

**TABLE OF CONTENTS**

	Page
<u>VOTING OF PROXIES</u>	1
<u>THE BOARD OF DIRECTORS</u>	1
<u>Board Committees</u>	1
<u>Shareholder Communications to the Board</u>	2
<u>Code of Ethics</u>	3
<u>PROPOSAL 1 ELECTION OF DIRECTORS</u>	3
<u>Executive Officers and Key Employees</u>	5
<u>Agreements Governing Appointment of Directors</u>	5
<u>COMPENSATION OF EXECUTIVE OFFICERS AND DIRECTORS</u>	6
<u>Compensation Discussion and Analysis</u>	6
<u>Summary Compensation Table and Discussion of Employment and Incentive Arrangements</u>	10
<u>Other Compensatory Arrangements</u>	10
<u>Employment Agreements</u>	10
<u>Events Affecting Stock Option Vesting and Exercise</u>	15
<u>Stock Option Plans</u>	16
<u>Restricted Stock Unit Award Plan</u>	17
<u>Outstanding Equity Awards at 2007 Year End and Option Exercises In 2007</u>	17
<u>Option Exercise and Stock Vested in Fiscal Year 2007</u>	18
<u>Securities Authorized for Issuance Under Equity Compensation Plans</u>	18
<u>Equity Compensation Plan Information</u>	18
<u>Potential Payments upon Termination or Change in Control</u>	19
<u>Compensation Committee Interlocks and Insider Participation</u>	21
<u>Compensation Committee Report</u>	21
<u>Section 16(a) Beneficial Ownership Reporting Compliance</u>	22
<u>Certain Relationships and Related Transactions and Director Independence</u>	22
<u>Certain Relationships and Related Transactions</u>	22
<u>Director Independence</u>	24
<u>Vote Required and Board Recommendation</u>	25
<u>PROPOSAL 2 RATIFICATION OF THE ADOPTION OF THE COMPANY'S 2008 STOCK</u>	26
<u>OPTION PLAN</u>	26
<u>Administration</u>	26
<u>Shares Subject to the 2008 Plan</u>	26
<u>Eligibility</u>	26
<u>Exercise Price of Options</u>	27
<u>Terms</u>	27
<u>Exercise of Options</u>	27
<u>Federal Income Tax Consequences Relating to Incentive Stock Options</u>	28
<u>Federal Income Tax Consequences Relating to Non-Qualified Stock Options</u>	29
<u>Amendments and Discontinuance of the 2008 Plan</u>	29
<u>New Plan Benefits</u>	30
<u>Vote Required</u>	30
<u>Recommendation of the Board of Directors</u>	30

<u>PROPOSAL 3 RATIFICATION OF AMENDMENT TO THE COMPANY'S 2005 RESTRICTED STOCK UNIT AWARD PLAN</u>	<u>31</u>
<u>Administration</u>	<u>31</u>
<u>RSU Plan Eligibility</u>	<u>32</u>
<u>Terms</u>	<u>32</u>

i

TABLE OF CONTENTS

	Page
<u>Amendment and Termination of the RSU Plan</u>	<u>33</u>
<u>Adjustments upon Changes in Capitalization or Merger</u>	<u>33</u>
<u>Tax Status of the RSU Plan</u>	<u>33</u>
<u>Vote Required</u>	<u>35</u>
<u>Recommendation of the Board of Directors</u>	<u>35</u>
<u>PROPOSAL 4 RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</u>	<u>36</u>
<u>Audit Committee's Pre-Approval Policies and Procedures</u>	<u>36</u>
<u>AUDIT COMMITTEE REPORT</u>	<u>37</u>
<u>Recommendation of the Board of Directors</u>	<u>37</u>
<u>Vote Required</u>	<u>37</u>
<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT</u>	<u>38</u>
<u>GENERAL</u>	<u>40</u>
<u>SHAREHOLDER PROPOSALS FOR 2009 ANNUAL MEETING</u>	<u>40</u>
Appendix A 2008 Stock Option Plan	A-1
Appendix B 2005 Restricted Stock Unit Award Plan	B-1

ii

TABLE OF CONTENTS

## VOTING OF PROXIES

Proxies may be revoked by shareholders at any time prior to the voting thereof by giving notice of revocation in writing to the Secretary of the Company or by voting in person at the Meeting.

If the enclosed proxy is properly signed, dated and returned, the Common Stock represented thereby will be voted at the Meeting and will be voted in accordance with the specifications made thereon. **IF NO INSTRUCTIONS ARE INDICATED, THE COMMON STOCK REPRESENTED THEREBY WILL BE VOTED** (i) **FOR** the election of Directors, (ii) **FOR** the ratification of the adoption of the Company's 2008 Stock Option Plan, (iii) **FOR** the ratification of the adoption of the amendment to the Company's 2005 Restricted Stock Unit Award Plan, to increase the shares available for issuance thereunder by 500,000 shares to 3,500,000 shares and (iv) **FOR** the ratification of the appointment of BDO Seidman, LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2008.

## THE BOARD OF DIRECTORS

During the year ended December 31, 2007, the Board of Directors held 21 meetings. Each of the Company's Board members, attended at least 75% of the aggregate of (1) all Board meetings held during 2007 and (2) the total number

of meetings held by all committees of the Board on which he served.

It is the policy of the Board that Directors are strongly encouraged to attend all Board meetings and shareholder meetings. We did not hold an annual meeting in 2007.

## Board Committees

During 2007, the Company had an Audit Committee and a Compensation Committee of the Board of Directors.

### Audit Committee

During 2007, the members of the Audit Committee of the Board of Directors were William A. Sumner, Chairman, Immanuel Thangaraj and Bruce F. Wesson. On January 24, 2008, the Audit Committee was reconstituted and effective at such date, the members are George K. Ross, Chairman, William A. Sumner and William G. Skelly. The Audit Committee is responsible for selecting our registered independent public accounting firm, approving the audit fee payable to the auditors, working with independent auditors and other corporate officials, reviewing the scope and results of the audit by, and the recommendations of, our independent auditors, approving the services provided by the auditors, reviewing our financial statements and reporting on the results of the audits to the Board, reviewing our insurance coverage, financial controls and filings with the Securities and Exchange Commission (the SEC), including meeting quarterly prior to the filing of our quarterly and annual reports containing financial statements filed with the SEC, and submitting to the Board its recommendations relating to our financial reporting, accounting practices and policies and financial, accounting and operational controls.

In assessing the independence of the Audit Committee members during 2007, our Board reviewed and analyzed the standards for independence provided in NASDAQ Marketplace Rule 4200(a)(15) and applicable SEC regulations.

Based on this analysis, our Board has determined that Mr. Sumner was an independent member of the Audit Committee, and that Messrs. Wesson and Thangaraj did not satisfy such standards for independence as a result of their positions in entities having a controlling interest in GCE Holdings, LLC, our 78% shareholder. GCE Holdings, LLC was the assignee of all our preferred shares previously held by each of Care Capital Investments II, LP, Essex Woodlands Health Ventures V, L.P. and Galen Partners III, L.P. In view of the controlling interests in GCE Holdings, LLC held by each of Galen Partners III, L.P., of which Mr. Wesson is a general partner, and Essex Woodlands Health Ventures V, L.P., of which Mr. Thangaraj is a general partner, each of Messrs. Wesson and Thangaraj fail to satisfy the standards for independence set forth in the listing standards of the NASDAQ Capital Market and applicable SEC regulations. Nevertheless, our Board valued the experience of Messrs. Wesson and Thangaraj in the review of our financial statements in 2007 and believes that each was able to exercise independent judgment in the performance of his duties on the Audit Committee during 2007.

In assessing the independence of the Audit Committee as currently comprised, our Board reviewed and analyzed the standards for independence provided in NASDAQ Marketplace Rule 4200(a)(15) and applicable

1

---

### TABLE OF CONTENTS

SEC regulations. Based on this analysis, our Board has determined that each of Messrs. Ross, Sumner and Skelly satisfies such standards for independence. Our Board also determined that Mr. Ross is a financial expert as provided in NASDAQ Marketplace Rule 4350(d)(2)(A) and SEC regulations.

The Charter of our Audit Committee is available on our website, [www.acurapharm.com](http://www.acurapharm.com), under the link Ethics/Audit Charter. During fiscal year 2007, the Audit Committee met 5 times.

## Compensation Committee

During 2007, the members of the Compensation Committee of the Board of Directors were Andrew D. Reddick, Richard J. Markham and William G. Skelly. On January 24, 2008, the Compensation Committee was reconstituted and effective at such date, the members are Richard J. Markham, Chairman, Bruce F. Wesson and Immanuel Thangaraj. This committee is responsible for consulting with and making recommendations to the Board of Directors about executive compensation and compensation of employees. See Compensation of Executive Officers and Directors Compensation Discussion and Analysis Board Process for a summary of the procedures for approving compensation for our senior management and employees. The Compensation Committee does not have a formal written charter. See Compensation of Executive Officers and Directors Compensation Discussion and Analysis, below.

Although the listing standards of the NASDAQ Capital Market specify that the compensation of our executive officers must be determined, or recommended to the Board, either by a majority of independent directors or a compensation committee comprised solely of independent directors, we are relying on the controlled company exemption provided in the listing standards of the NASDAQ Capital Market in having each of Messrs. Markham, Wesson and Thangaraj as members of the Compensation Committee. During fiscal year 2007, the Compensation Committee met 1 time.

## Nominating Committee

Currently our entire Board of Directors functions as our nominating committee. As needed, the Board will perform the functions typical of a nominating committee, including the identification, recruitment and selection of nominees for election to our Board. Three of our seven members of the Board (Messrs. Sumner, Skelly and Ross) are independent as that term is defined under the rules of the NASDAQ Capital Market and SEC regulations and participate with the entire Board in the consideration of director nominees. We believe that a nominating committee separate from the Board is not necessary at this time, given our relative size and the size of our Board and that an additional committee of the Board would not add to the effectiveness of the evaluation and nomination process. The Board's process for recruiting and selecting nominees for Board members, if required, would be to identify individuals who are thought to have the business background and experience, industry specific knowledge and general reputation and expertise allowing them to contribute as effective directors to our governance, and who would be willing to serve as directors of a public company. To date, we have not engaged any third party to assist in identifying or evaluating potential nominees. If a possible candidate is identified, the individual will meet with each member of the Board and be sounded out concerning his/her possible interest and willingness to serve, and Board members would discuss amongst themselves the individual's potential to be an effective Board member. If the discussions and evaluation are positive, the individual would be invited to serve on the Board. To date, no shareholder has presented any candidate for Board membership for consideration, and we therefore think it is appropriate not have a specific policy on shareholder-recommended director candidates. The Board believes its process for evaluation of nominees proposed by shareholders would be no different than the process of evaluating any other candidate.

## Shareholder Communications to the Board

Shareholders who wish to send communications to our Board of Directors may do so by sending them in care of our Secretary at the address on the cover page of this Proxy Statement. The envelope containing such communication must contain a clear notation indicating that the enclosed letter is a Shareholder-Board Communication or Shareholder-Director Communication or similar statement that clearly and unmistakably indicates the communication is intended for the Board. All such communications must clearly indicate the author as a shareholder and state whether the intended recipients are all members of the Board or just certain specified directors. Our Secretary will have the discretion to screen and not forward to directors

TABLE OF CONTENTS

communications which the Secretary determines in his or her discretion are communications unrelated to our business or our governance, commercial solicitations, or communications that are offensive, obscene, or otherwise inappropriate. The Secretary will, however, compile all shareholder communications which are not forwarded and such communications will be available to any director.

## Code of Ethics

Our Code of Ethics applicable to our principal executive officer, principal financial officer, principal accounting officer and all of our other employees is available on our website, [www.acurapharm.com](http://www.acurapharm.com), under the link Ethics/Audit Charter .

## PROPOSAL 1

### ELECTION OF DIRECTORS

At the Meeting, seven individuals will be elected to serve as Directors until the next annual meeting, and until their successors are elected and qualified. During the fiscal year ended December 31, 2007, each of the nominees to the Board, with the exception of George Ross, served as Directors. Mr. Ross was elected as a director on January 24, 2008.

Unless a shareholder **WITHHOLDS AUTHORITY**, a properly signed and dated proxy will be voted **FOR** the election of the persons named below, unless the proxy contains contrary instructions. Management has no reason to believe that any of the nominees will not be a candidate or will be unable to serve as a Director. However, in the event any nominee is not a candidate or is unable or unwilling to serve as a Director at the time of the election, unless the shareholder withholds authority from voting, the proxies will be voted for any nominee who shall be designated by the present Board of Directors to fill such vacancy.

Although our Restated Certificate of Incorporation provides for a maximum of 11 directors, in accordance with the terms of a certain Voting Agreement dated February 6, 2004, by and among the Company, GCE Holdings LLC and others, as amended, we have agreed that the Board of Directors shall be comprised of not more than seven members, three of whom are designees of GCE, one of whom is our Chief Executive Officer and three of whom are independent directors. The Voting Agreement also provides that GCE's right to designate directors terminates on the date it ceases to be a holder of at least 2,500,000 shares (including shares underlying warrants) of our common stock. Furthermore, from and after the date GCE no longer holds at least 10,000,000 shares (including shares underlying warrants), its rights to designate board members will be reduced from three directors to two directors, with the forfeited seat becoming a seat for an independent director to thereafter be nominated and elected to the Board of Directors from time to time by the then current directors. Finally, from and after the date GCE ceases to hold at least 5,000,000 shares (including shares underlying warrants) it has the right to designate only one director, with the additional forfeited seat becoming a seat for an independent director to thereafter be nominated and elected to the Board of Directors from time to time by the then current directors.

The name and age of each of the seven nominees, his principal occupation and the period during which such person has served as a Director are set out below.



Name of Nominee	Age	Position with the Company	Director Since
Andrew D. Reddick	55	President and CEO and Director	2004
William A. Sumner <sup>(1)</sup>	70	Director	1997
William G. Skelly <sup>(1)</sup>	56	Director	1996
Richard J. Markham <sup>(2)</sup>	57	Director	2006
Bruce F. Wesson <sup>(2)</sup>	65	Director	1998
Immanuel Thangaraj <sup>(2)</sup>	37	Director	2002
George K. Ross <sup>(1)</sup>	66	Director	2008

(1)

Member of Audit Committee

(2)

Member of Compensation Committee

3

### TABLE OF CONTENTS

**Andrew D. Reddick** has been President and Chief Executive Officer since August, 2003 and a member of our Board of Directors since August, 2004. From April, 2000 to September, 2002 Mr. Reddick was Chief Operating Officer and Sr. Vice President Commercial Operations for Adolor Corporation and from June, 1999 to March, 2000 he served as President of Faulding Laboratories, Inc. Mr. Reddick holds a Bachelor of Arts degree in Biology from the University of California and a Masters of Business Administration degree from Duke University.

**Bruce F. Wesson** has been a member of our Board of Directors since March, 1998. Mr. Wesson has been a Partner of Galen Associates, a health care venture firm, and a General Partner of Galen Partners III, L.P. since January 1991. Prior to January, 1991, he was Senior Vice President and Managing Director of Smith Barney, Harris Upham & Co. Inc., an investment banking firm. He currently serves on the Boards of Derma Sciences, Inc., and Chemtura Corporation, each a publicly traded company and is Vice Chairman of the Board of MedAssets, Inc. Mr. Wesson earned a Bachelor of Arts degree from Colgate University and a Masters of Business Administration from Columbia University.

**William A. Sumner** has been a member of our Board of Directors since August, 1997. From 1974 until his retirement in 1995, Mr. Sumner held various positions within Hoechst-Roussel Pharmaceuticals, Inc., including Vice President and General Manager, Dermatology Division from 1991 through 1995, Vice President, Strategic Business Development, from 1989 to 1991 and Vice President, Marketing from 1985 to 1989. Since his retirement from Hoechst-Roussel Pharmaceuticals, Inc. in 1995, Mr. Sumner has served as a consultant in the pharmaceutical industry. Mr. Sumner earned a Bachelor of Arts degree from Montclair State University and a Master of Arts degree from the University of Virginia.

**Richard J. Markham** has been a member of our Board of Directors since May, 2006 and was elected non-executive Chairman of the Board in February, 2008. Since November, 2004 Mr. Markham has served as a partner at Care Capital, LLC, a venture capital firm that primarily invests in life sciences companies. From May 2002 until August 2004, Mr. Markham was the Vice Chairman of the Management Board and Chief Operating Officer of Aventis SA. From December, 1999 until May, 2002 he was the Chief Executive Officer of Aventis Pharma AG. Previously he was the Chief Executive Officer of Hoechst Marion Roussel, the President and Chief Operating Officer of Marion Merrell Dow, Inc. and a member of its board of directors. From 1973 to 1993 Mr. Markham was associated with Merck & Co. Inc., culminating in his position as President and Chief Operating Officer. Mr. Markham received a B.S. in Pharmacy and Pharmaceutical Sciences from Purdue University.

**William G. Skelly** has been a member of our Board of Directors since May, 1996 and served as our Chairman from October, 1996 through June, 2000. Since 1990, Mr. Skelly has served as Chairman, President and Chief Executive Officer of Central Biomedica, Inc. and its subsidiary SERA, Inc. From 1985 to 1990, Mr. Skelly served as President of

Martec Pharmaceutical, Inc. Mr. Skelly earned a Bachelor of Arts degree from Michigan State University and a Masters of Business Administration from the University of Missouri-Kansas City.

**Immanuel Thangaraj** has been a member of our Board of Directors since December, 2002. Mr. Thangaraj has been a Managing Director of Essex Woodlands Health Ventures, a venture capital firm specializing in the healthcare industry, since 1997. Prior to joining Essex Woodlands Health Ventures, he helped establish a telecommunication services company, for which he served as its CEO. Mr. Thangaraj holds a Bachelor of Arts and a Masters in Business Administration from the University of Chicago.

**George K. Ross** has been a member of our Board of Directors since January, 2008. Since April 2002, Mr. Ross has been a consultant to early stage businesses and a financial investor. Since July 2005 he has served as Executive Director, Greater New York for World Vision. His business career has included senior financial officer and board member positions with both public and private companies in diverse industries. Mr. Ross was Executive Vice President and Chief Financial Officer and a board member of Tier Technologies Inc. from February 1997 to January 2000, which became a public company during this period. Mr. Ross is a Certified Public Accountant and earned a Bachelor of Arts degree from Ohio Wesleyan University and a Masters of Business Administration from Ohio State University.

The Board had determined that Messrs. Skelly, Sumner and Ross are independent directors.

4

---

TABLE OF CONTENTS

## **Executive Officers and Key Employees**

*Andrew D. Reddick*, President and Chief Executive Officer.

**Ron J. Spivey, Ph.D.**, has been Senior Vice President and Chief Scientific Officer since April, 2004. From June, 2002 to March, 2004 Dr. Spivey was President of Gibraltar Associates, a private consulting services company for the pharmaceutical industry. From March, 1998 to May, 2002 he served as Vice President, Scientific Affairs for Alparma/Purepac Pharmaceuticals. Dr. Spivey holds a Bachelor of Arts degree from Indiana University and a Ph.D. degree in pharmaceutics from the University of Iowa. Age 61.

**Robert B. Jones** will be employed as our Senior Vice President and Chief Operating Officer commencing April 7, 2008. From May, 2003 to March, 2008 Mr. Jones served first as the Vice President, Finance and then as Vice President, Strategy and Business Analysis of Adolor Corporation, a biopharmaceutical company. From November, 2000 to May, 2003 he served as Vice President, Finance and then as Chief Operating Officer of Opt-E-Scrip, Inc., a privately held personalized medicine company where Mr. Jones was responsible for all commercialization activities. Prior to that, Mr. Jones was Vice President, Sales and Marketing for Purepac Pharmaceutical Company. Prior to his experience with Purepac, Mr. Jones was Vice President, Marketing and Business Development for Endeavor Pharmaceuticals, Inc. and during the course of nine years with Burroughs Wellcome Company he held several roles of increasing responsibility in the finance and marketing departments. Mr. Jones received his M.B.A. from the University of North Carolina and a B.S. from Cornell University. Age: 49.

**Peter A. Clemens** has been Senior Vice President, Chief Financial Officer and Secretary since April 2004. Mr. Clemens was our Vice President, Chief Financial Officer and Secretary from February 1998 to March 2004 and a member of our Board of Directors from June, 1998 to August, 2004. Mr. Clemens is a Certified Public Accountant and earned a Bachelor of Business Administration degree from the University of Notre Dame and a Masters of Business Administration from Indiana University. Age 55.

**James F. Emigh** has been Vice President of Marketing and Administration since April 2004. Prior to such time, Mr. Emigh was our Vice President of Sales and Marketing. Mr. Emigh joined us in May, 1998, serving first as Executive Director of Customer Relations and then as Vice President of Operations until November, 2002. Mr. Emigh holds a Bachelor of Pharmacy degree from Washington State University and a Masters of Business Administration from George Mason University. Age 52.

**Robert A. Seiser** has been Vice President, Corporate Controller and Treasurer since April 2004. Mr. Seiser joined us in March 1998 as our Corporate Controller and Treasurer. Mr. Seiser is a Certified Public Accountant and earned a Bachelor of Business Administration degree from Loyola University of Chicago. Age 44.

The term of office of each person elected as a director will continue until the next annual meeting of shareholders and until such person's successor has been elected and qualified. Officers are appointed by the Board of Directors and serve at the discretion of the Board, although the employment of Andrew D. Reddick, our President and Chief Executive Officer, Ron J. Spivey, our Senior Vice President and Chief Scientific Officer, Robert B. Jones, our Senior Vice President and Chief Operating Officer and Peter A. Clemens, our Senior Vice President and Chief Financial Officer, are subject to the provisions of their respective Employment Agreements. See Compensation of Executive Officers and Directors Employment Agreements.

## Agreements Governing Appointment of Directors

See Election of Directors above, for a discussion of the Voting Agreement that entitles GCE Holdings LLC to designate up to three (3) directors.

5

---

### TABLE OF CONTENTS

## COMPENSATION OF EXECUTIVE OFFICERS AND DIRECTORS

*Unless otherwise noted all share and share price information with respect to our common stock give effect to a 1 for 10 reverse stock split effected December 5, 2007.*

### Compensation Discussion and Analysis

Our executive compensation program consists of (i) an annual salary and bonus compensation and (ii) equity incentives represented by the issuance of stock options and restricted stock units ( RSUs ). The salary, bonuses, and equity incentives serve to link executive pay to corporate performance.

#### Policies for Allocating Between Various Forms of Compensation

In the past few years, because we had insufficient cash reserves, our ability to pay cash bonuses and increase salaries was limited. As a result, we did not grant cash bonuses or increase salaries to our principal executives in 2004, 2005 or 2006. Instead we sought to incentivize our senior management with equity compensation in the form of stock options and RSUs.

In 2004 and 2005 we issued stock options to our employees with an exercise price at a discount to the then current trading price for our common stock. Because our stock price is based on relatively low trading volume and a small

public float, it can fluctuate widely at times. As a result, we determined that the issuance of RSUs presented a number of advantages. First, it allows us to reduce the dilutive effect of this equity-based compensation, as there are fewer shares underlying a restricted stock award than an equivalent stock option award. Second, the vesting schedule of the RSUs was structured to minimize the potential excise tax under Section 280G of the Internal Revenue Code upon a change of control. Third, stock options issued at a discount have unfavorable tax and accounting consequences. Fourth, it can be difficult to set an exercise price for options due to the low trading volume and small public float for our common stock.

As a result, in 2005 we established a restricted stock unit plan (the 2005 RSU Plan ) and issued RSUs aggregating 2,750,000 shares to employees. Of such RSU awards, 30%, 24%, 16%, 6% and 5% were issued to Messrs. Reddick, Spivey, Clemens, Seiser and Emigh, respectively (the named executive officers ). It is likely we will maintain a similar ratio of distribution of equity awards in the future, to those persons and/or persons in similar positions. In addition, RSUs with respect to 100,000 shares were issued to each of our two independent directors in 2006.

Following the completion of our Unit Offering in August 2007, described in Certain Relationships and Related Transactions and Director Independence and the consummation of a licensing transaction (the King Agreement ) with a subsidiary of King Pharmaceuticals, Inc. ( King ) in December 2007, our cash position improved and we were able to increase salaries and grant bonuses to our employees as discussed below under the caption *Salary and Bonus* . While we also intend to award equity-based compensation, our objective is to award cash bonuses and grant salary increases on an annual basis going forward. The amounts and timing of any such awards will be subject to available cash reserves and the satisfaction of employee performance objectives established by our Chief Executive Officer and the Compensation Committee.

In 2007, no stock options or RSU awards were made to senior management. In view of our improved cash reserves following the closing of the King Agreement, and recognizing that no salary increases or bonuses had been awarded to senior management over the prior four years, the Compensation Committee and the Board determined that salary increases and bonuses for each named executive officer was appropriate. As part of its analysis the Compensation Committee and the Board considered the stock option and RSU awards previously made to the named executive officers in 2004, 2005 and 2006 and determined that additional equity incentive compensation was not warranted in 2007.

## **Salary and Bonus**

Each of Andrew D. Reddick, Ron J. Spivey, Robert B. Jones and Peter A. Clemens are parties to employment agreements, described under the caption Employment Agreements below, which provide the minimum annual base salary to be payable to such officers, subject to increase at the discretion of the Board. Effective January 1, 2008, Mr. Reddick's, Spivey's and Clemens' salaries were increased to \$365,000 (from \$300,000), \$315,000 (from \$260,000) and \$205,000 (from \$180,000), respectively. Mr. Jones' employment with us will commence on April 7, 2008 at an annual salary of \$290,000. In addition, the employment

6

---

### TABLE OF CONTENTS

agreements provide for annual bonus payments, in the discretion of the Compensation Committee or the Board, subject to the satisfaction of such targets, conditions or parameters as may be agreed upon from time to time by the employee and the Compensation Committee. In determining the salary increase for each of Messrs. Reddick, Spivey and Clemens, the Compensation Committee and the Board considered that, due to our insufficient cash reserves, such executive officers had not received any salary increase or bonuses during the prior four years. The amount of the salary increases were based on a percentage increase, on average, slightly greater than the Consumer Price Index year

for each during the four year period ended December 31, 2007. In addition, in December 2007, Messrs. Reddick, Spivey and Clemens were awarded bonuses of \$850,000, \$650,000 and \$180,000, respectively. These amounts were based on a percentage of such executive's base salary, ranging from 25% to 70%, for each year during the four year period ended December 31, 2007 (corresponding to the period over which no bonuses were paid to senior management because of our limited cash reserves). The salary and bonus performance targets for Messrs. Reddick, Spivey, Jones and Clemens for 2008 consist of advancing our Acurox™ (oxycodone HCl and niacin) Tablets and other products using our Aversion® Technology through proof of concept and clinical developments, implementing the King Agreement, licensing of additional products to King through the exercise of King's options under the King Agreement and licensing products derived from our Aversion® Technology outside of North America.

No compensation will be earned with respect to a performance measure unless a performance floor for that measure is exceeded; the incentive opportunity with respect to a measure will be earned if the target is achieved; achievement between the floor and the target results in a lower amount of award with respect to that performance measure. An amount larger than the incentive opportunity for each performance measure can be earned, up to and possibly exceeding a specified limit, for exceeding the target for that measure. In setting compensation levels, the Compensation Committee compares our Company to companies of comparable business focus, market capitalization, technological capabilities and market in which we compete for executives. As part of this process, the Compensation Committee and the Board does not use the compensation levels of comparable companies as benchmarks, rather as a factor in evaluating the compensation levels of the named executive officer. To date, compensation consultants have not been retained by the Compensation Committee or the Board as part of this process.

In ascertaining the achieved level of performance against the targets, the effects of certain extraordinary events, as determined by the Compensation Committee, such as (i) major acquisitions and divestitures, (ii) significant one-time charges, and (iii) changes in accounting principles required by the Financial Accounting Standards Board, are compensation neutral for the year in which they occurred; that is, they are not taken into account in determining the degree to which the targets are met in that year.

The Compensation Committee may, after a review of an executive's performance, recommend to the Board that a bonus award be made to such executives based upon other non-enumerated performance targets (whether or not they are parties to employment agreements). This could result in the award of salary increases or bonuses above a targeted range amount. In 2007, as reflected in the Summary Compensation Table, bonuses were paid after the closing of the King Agreement.

For those named executive officers not subject to an employment contract (Messrs. Emigh and Seiser), the Compensation Committee will set the annual salary for such named executive officers between December and March and establish potential bonus compensation that such executives may earn based upon quantitative and, if applicable, qualitative performance goals established by the Compensation Committee. Effective January 1, 2008, Messrs. Emigh's and Seiser's salaries were increased to \$160,000 (from \$140,000) and \$160,000 (from \$133,000), respectively. In determining the salary increase for each of Messrs. Emigh and Seiser, the Compensation Committee and the Board considered that, due to our insufficient cash reserves, such executive officers had not received any salary increase or bonuses during the prior four years. The amount of the salary increases were based on a percentage increase, on average, slightly greater than the Consumer Price Index for each year during the four year period ended December 31, 2007. In addition, in December 2007, Messrs. Emigh and Spivey were each awarded bonuses of \$140,000. This amount was based on a percentage of such executive's base salary, ranging from 26% to 32%, for each year in the four year period ended December 31, 2007 (corresponding to the period over which no bonuses were paid to senior management because of our limited cash reserves).

---

TABLE OF CONTENTS

## Stock Options

One long-term component of our executive compensation program consists of stock option grants. The options generally permit the option holder to buy the number of shares of our Common Stock covered by the option (an option exercise ) at a price fixed at the time of grant. While we have historically granted stock options having an exercise price equal to the fair market value of our Common Stock on the date of grant, during 2004 and 2005, we issued stock options to our employees at a discount to the trading price of our common stock. The vesting of these options during 2006 and 2007 is reflected in the Option Awards options column of the Summary Compensation Table below. It is our expectation that discounted stock option grants will occur only on an isolated basis in the future where circumstances warrant. With respect to stock options grants having an exercise price equal to the market price of our Common Stock on the date of grant, such options generally gain value only to the extent our stock price exceeds the option exercise price during the life of the option. Generally, a portion of the options vest over a period of time if the option holder remains an employee and expire no later than ten years after grant. Executives will generally be subject to limitations in selling the option stock immediately due to securities law considerations, and therefore will have an incentive to increase shareholder value. As of December 31, 2007, Messrs. Reddick and Spivey were fully vested in their stock options. Stock options for 9,375, 6,225, and 6,225 shares remain to vest for Messrs. Clemens, Emigh and Seiser, respectively. In 2007 no additional option grants were made to the named executive officers as the Compensation Committee and the Board elected to grant salary increases and bonuses instead based on our improved cash position and the absence of the award of such cash incentives during the prior four years. On April 7, 2008, the commencement date of his employment with us, Mr. Jones will be granted options to purchase 30,000 shares of Common Stock, which vest at the rate of 1,500 shares on the last day of each month commencing May 31, 2008.

## Timing Policies with Respect to Options

We have no plan or practice to time option grants in coordination with the release of non-public information and we do not time the release of non-public information to affect the value of executive compensation. Option grant dates for options issued to new executive officers will likely be the date of their employment or execution of their agreements. Any such options may be issued at a discount to take into account the limited public float and the wide ranges in our stock price.

## Restricted Stock Units

Another component of our executive compensation program is the grant of RSUs under our 2005 RSU Plan. A RSU represents a contingent obligation to deliver a share of our common stock to the holder of the RSU on a distribution date. Each RSU award made to our executives in 2005 vested one-third (1/3) upon grant and the balance in equal monthly increments on the first day of each month beginning January 1, 2006 and ending December 1, 2007. We will issue the vested shares underlying the RSU awards on the earlier of (i) a Change of Control (as defined in our 2005 RSU Plan), or (ii) in four annual installments starting on January 1, 2011. In the event of a Change of Control, our issuance of the vested shares shall be made in a lump sum distribution. In the absence of a Change of Control, the issuance of the vested shares shall be made in four (4) equal installments on each of January 1, 2011, January 1, 2012, January 1, 2013 and January 1, 2014. Upon our distribution of the vested shares underlying the RSU awards, the recipients must submit to us the par value of \$0.01 per share. In 2005, we granted Messrs. Reddick, Spivey, Clemens, Seiser and Emigh RSU awards with respect to 825,000, 660,000, 440,000, 165,000 and 137,500 underlying shares, respectively. In the case of Messrs. Reddick, Spivey and Clemens, such awards are reflected in their employment agreements. The vesting during 2006 and 2007 of the RSUs granted in 2005 is reflected in the Stock Awards column of the Summary Compensation Table, below. As of December 31, 2007, all named executive officers were fully vested in their RSUs. In 2007 no additional RSUs were granted to the named executive officers as the Compensation Committee and the Board elected to grant salary increases and bonuses instead based on our improved cash position and the absence of the award of such cash incentives during the prior four years. On April 7, 2008, the commencement date of his employment with us, Mr. Jones will be granted 50,000 RSUs which will vest at the rate of 2,500 restricted

stock units on the last day of each calendar month commencing May 31, 2008.

8

---

## TABLE OF CONTENTS

### **Termination/Severance Benefits**

The employment agreement of each of Messrs. Reddick, Clemens, Jones and Spivey provides severance benefits under certain circumstances. The severance benefits provided to each such executive differ, but include payments of a pro rata bonus or non equity incentive compensation, one to two years of salary and one to two years of benefits. See

Employment Agreements and Quantifying Termination/Change of Control Payments in the section entitled Compensation of Executive Officers and Directors . We believe severance arrangements for the highest level officers help them to focus on their respective job functions even while we are experiencing some financial difficulties and gives them comfort that we will not lightly terminate their employment. We believe these severance benefits were necessary to be able to initially hire and to retain these executives. In turn Messrs. Reddick, Spivey, Jones and Clemens have agreed after their employment with us ends under certain circumstances not to compete or solicit our employees for hire for a limited period of time. We believe that such non-compete and non-solicit provisions are important to protect our business. The severance benefits are standard in employment contracts and were the results of negotiations between us and our executives.

The other executive officers named in the Summary Compensation Table have no contractual severance benefits if terminated by the Company other than acceleration of vesting of their RSUs.

### **Retirement Plans**

We maintain a 401(k) plan that allows us to make both discretionary and matching contributions, but we have not done so since inception. We have no pension plans or non-qualified deferred compensation plans and, as a result, the columns relating to such plans in the Summary Compensation Table are blank.

### **Change in Control**

Currently unexercisable options vest with respect to all underlying shares upon a change of control (as defined in employment agreements, in the case of Messrs. Reddick, Spivey, Jones and Clemens, and in stock option agreements, in the case of Messrs. Emigh and Seiser) for all named executive officers. In addition, discounted options that are subject to Section 409A of the Internal Revenue Code of 1986, as amended ( Section 409A), become exercisable upon a change of control that qualifies as a change of control under Section 409A. In addition, RSUs vest with respect to all underlying shares upon a change of control and are distributed upon a change of control (provided the requirements of Section 409A are met). In addition, Messrs. Reddick, Spivey, Jones and Clemens receive severance and bonuses if they terminate their employment after a change of control (as defined in their employment agreements), or we terminate their employment after a change of control. We feel our change of control provisions incentivize our executives to seek opportunities for us and realize benefits from a change of control transaction even though such change of control may lead to the termination of their positions.

### **Tax Reimbursements**

Because of the so-called parachute tax imposed by Internal Revenue Code Section 280G, our named executive officers may be subject to such tax upon the exercise of options and distributions under RSUs upon a change of control. We currently have no agreements to reimburse our named executive officers for any taxes imposed as a result

of these additional excise taxes. We will pay taxes incurred by Messrs. Reddick, Jones and Spivey on a lump sum distribution of the value of twelve months of benefits, which they may elect in lieu of continued benefits, in the event their employment terminates under certain circumstances.

## Perquisites and Other Benefits

Our executive officers receive no perquisites. We have not made either discretionary or matching contributions to their 401(k) plans, although our plan provides that we may do so. Our executive officers are not provided auto allowances and they receive no country club or golf club memberships. We may, however, consider such perquisites in the future.

## Board Process

The Compensation Committee of the Board of Directors approves all compensation and awards to the named executive officers and thereafter submits its recommendation to the full Board for approval. All such decisions are made with the consultation of the Chief Executive Officer, except those relating to the

9

### TABLE OF CONTENTS

compensation of the Chief Executive Officer. With respect to cash or equity compensation awards to our other employees, the Compensation Committee makes recommendations of bonus awards, salary increases, equity grants to the Board, with the Board approving such awards. Except for salary adjustments and cash bonus and equity awards to the Chief Executive Officer, these items are generally based upon the recommendation of the Chief Executive Officer.

For example, in 2007, the Chief Executive Officer made recommendations with respect to bonuses and salary increases for all other employees (other than himself) and the Compensation Committee and Board reviewed and adopted such recommendations. With respect to salary adjustments and cash bonus and equity items to the Chief Executive Officer, the Compensation Committee (excluding Mr. Reddick) establishes such awards for the Chief Executive Officer subject to review and approval of the Board.

## Summary Compensation Table and Discussion of Employment and Incentive Arrangements

The following table sets forth a summary of the compensation paid by us for services rendered in all capacities to us during the fiscal years ended December 31, 2006 and December 31, 2007 to our Chief Executive Officer, Chief Financial Officer and our next three most highly compensated executive officers (collectively, the named executive officers ) whose total annual compensation for 2006 and/or 2007 exceeded \$100,000:

### Summary Compensation Table

Name and Principal Position	Year	Base Salary (\$)	Bonus (\$)	Stock Awards <sup>(1)</sup> (\$)	Option Awards <sup>(2)</sup> (\$)	Total (\$)
Andrew D. Reddick President & CEO	2006	300,000		1,375,000	\$77,000	1,752,000
	2007	300,000	850,000	264,000	0	1,414,000
	2006	180,000		733,000	23,000	936,000



Peter A. Clemens SVP & CFO	2007	180,000	180,000	141,000	11,000	512,000
Ron J. Spivey SVP and Chief Scientific Officer	2006	260,000		1,110,000	166,000	1,536,000
James F. Emigh VP, Marketing & Administration	2007	260,000	650,000	211,000	0	1,121,000
Robert A. Seiser VP, Corporate Controller & Treasurer	2006	140,000		229,000	16,000	385,000
	2007	140,000	140,000	44,000	7,000	331,000
	2006	133,000		275,000	16,000	424,000
	2007	133,000	140,000	53,000	7,000	333,000

The 2006 and 2007 entries reflect the vesting in each of 2006 and 2007 of outstanding RSUs with respect to 275,000, 146,600, 220,000, 45,833 and 55,000 underlying shares for Messrs. Reddick, Clemens, Spivey, Emigh (1) and Seiser, respectively. The dollar amount provided is the compensation cost for such awards recognized in 2006 and 2007 in accordance with FAS 123R, as reflected in our financial statements disregarding the risk of forfeiture relating to service-based vesting conditions.

The 2006 entries reflect the vesting in 2006 of outstanding options with respect to 150,000, 9,375, 433,333, 6,225 and 6,225 underlying shares for Messrs. Reddick, Clemens, Spivey, Emigh and Seiser, respectively. The 2007 (2) entries reflect the vesting in 2007 of outstanding options with respect to 9,375, 6,225 and 6,225 underlying shares for Messrs. Clemens, Emigh and Seiser, respectively. The dollar amount reported is the compensation cost for such awards recognized in 2006 and 2007 in accordance with FAS 123R, as reflected in our financial statements.

## Other Compensatory Arrangements

Our executive officers participate in medical, dental, life and disability insurance plans provided to all of our employees.

## Employment Agreements

Andrew D. Reddick is employed pursuant to an Employment Agreement effective as of August 26, 2003, as amended, which provides that Mr. Reddick will serve as our Chief Executive Officer and President for a term expiring December 31, 2008. The term of the Employment Agreement provides for automatic one (1)

10

---

### TABLE OF CONTENTS

year renewals in the absence of written notice to the contrary from us or Mr. Reddick at least ninety (90) days prior to the expiration of the initial term or any subsequent renewal period. Mr. Reddick's base salary under the Employment Agreement is \$365,000 (increased by the Board from \$300,000 effective January 1, 2008). Pursuant to the Employment Agreement, Mr. Reddick is entitled to an annual bonus based on the achievement of such targets, conditions, or parameters as may be set from time to time by the Board of Directors or the Compensation Committee of the Board of Directors. For our 2007 fiscal year, Mr. Reddick was awarded a bonus of \$850,000 due to, among other reasons, the successful completion of our Unit Offering and the King Agreement. The Employment Agreement also provides for our grant to Mr. Reddick of stock options exercisable for up to 875,000 shares of Common Stock at an exercise price of \$1.30 per share. The stock options provide for vesting of 300,000 shares on the date of grant of the option, with the balance vesting in monthly increments of 25,000 shares at the expiration of each monthly period thereafter commencing with the month ending August 31, 2004. The exercise price of \$1.30 per share represents a discount to the fair market value of our common stock on the date of grant. On August 12, 2004, the date of grant of the stock options, the average of the closing bid and asked prices for our Common Stock was \$4.35. Because 450,000 of the discounted options are subject to Section 409A, in 2007, we established an exercise schedule to comply with

Section 409A for such 450,000 options so that the options are exercisable (subject to earlier exercisability as set forth in the table below entitled "Events Affecting Option Vesting and Exercise") in four equal installments on January 1 of each of 2011, 2012, 2013 and 2014, provided that such options may be exercised only in the calendar year in which they first become exercisable, and in no event later than August 11, 2014. The Employment Agreement also acknowledges the grant to Mr. Reddick of a Restricted Stock Unit Award providing for our issuance of up to 825,000 shares of our Common Stock. The Restricted Stock Unit vested one-third (1/3) upon grant and the balance in equal monthly increments on the first day of each month beginning January 1, 2006 and ending December 1, 2007. The vested shares underlying the Restricted Stock Unit Award will be issued by us on the earlier of (i) a Change in Control (as defined in our 2005 RSU Plan), or (ii) January 1, 2011. In the event of a Change in Control, we will issue the vested shares in a lump sum distribution. In the absence of a Change of Control, the issuance of the vested shares shall be made in four (4) equal installments on each of January 1, 2011, January 1, 2012, January 1, 2013 and January 1, 2014. Upon issuance of the shares underlying the Restricted Stock Unit Award, Mr. Reddick must remit to us the par value of \$0.01 per share. On December 22, 2005, the date of grant of the Restricted Stock Unit Award, the average of the closing bid and asked prices of our common stock was \$3.33, as reported by the OTCBB. Mr. Reddick has no rights as a stockholder, including no dividend or voting rights, with respect to the shares underlying the Restricted Stock Unit Award until we issue the shares. The Employment Agreement contains standard termination provisions, including upon death, disability, for Cause, for Good Reason and without Cause. In the event the Employment Agreement is terminated due to death or disability, we are required to pay Mr. Reddick, or his designee, a pro rata portion of the annual bonus that would have been payable to Mr. Reddick during such year assuming full achievement of the bonus criteria established for such bonus.

In the event that the Employment Agreement is terminated by us without Cause or by Mr. Reddick for Good Reason, we are required to pay Mr. Reddick an amount equal to the bonus for such year, calculated on a pro rata basis assuming full achievement of the bonus criteria for such year (to the extent it has not already been paid), as well as Mr. Reddick's base salary for one year (such salary amount being the "Severance Pay"). In case of termination without Cause, such severance is payable in equal monthly installments over a period of twelve (12) months, and in the case of termination by Mr. Reddick for Good Reason, one-half of such severance is payable six months after termination, and the remaining half of such severance is payable thereafter in six monthly installments. In addition, Mr. Reddick is at his option entitled to continued coverage under our then existing benefit plans, including medical and life insurance, for twelve (12) months from the date of termination or the value of such benefits payable in a lump sum thirty days of termination together with amount needed to pay income tax on such lump sum. The Employment Agreement permits Mr. Reddick to terminate the Employment Agreement in the event of a Change in Control (as defined in the Employment Agreement), in which case such termination is considered to be made without Cause, entitling Mr. Reddick to the benefits described above, except that (i) the Severance Pay is payable in a lump sum within six months after the date of termination, and (ii) with options being treated as set forth in the table below entitled, "Events Affecting Option Vesting and Exercise." The Employment Agreement restricts Mr. Reddick from disclosing, disseminating or using for his personal benefit or for the benefit of others, confidential or

11

---

## TABLE OF CONTENTS

proprietary information (as defined in the Employment Agreement) and, provided we have not breached the terms of the Employment Agreement, from competing with us at any time prior to one year after the termination of his employment with us. In addition he has agreed not to (and not to cause or direct any person to) hire or solicit for employment any of our employees or those of our subsidiaries or affiliates (i) for six (6) months following the termination of his employment by us without Cause or by him for Good Reason, prior to a Change of Control, (ii) for twelve (12) months following the termination of his employment for Cause, prior to a Change of Control, or (iii) twenty-four (24) months following a Change of Control. The table entitled "Events Affecting Option Vesting and Exercise," below summarizes the vesting and exercisability of Mr. Reddick's options following a number of termination scenarios or a Change of Control. Ron J. Spivey, Ph.D., is employed pursuant to an Employment Agreement effective

as of April 5, 2004, as amended, which provides that Dr. Spivey will serve as our Senior Vice President and Chief Scientific Officer for term expiring December 31, 2008. The term of the Employment Agreement provides for automatic one (1) year renewals in the absence of written notice to the contrary from us or Dr. Spivey at least ninety (90) days prior to the expiration of the initial term or any subsequent renewal period. Dr. Spivey's base salary under the Employment Agreement is \$315,000 (increased by the Board from \$260,000 effective January 1, 2008). Pursuant to the Employment Agreement Dr. Spivey is eligible for annual bonuses based on the achievement of such targets, conditions, or parameters as may be set from time to time by the Board of Directors or the Compensation Committee of the Board of Directors. In 2007, Dr. Spivey was awarded a bonus of \$650,000 due to, among other reasons, the completion of our Unit Offering and the King Agreement. The Employment Agreement also provides for our grant to Mr. Spivey of stock options exercisable for up to 700,000 shares of Common Stock at an exercise price of \$1.30 per share. The stock option provides for vesting of 100,000 shares on October 1, 2004, 33,333 shares on each January 1, 2005, April 1, 2005, July 1, 2005 and October 1, 2005, 388,867 shares on January 1, 2006 and 77,800 on April 1, 2006. The exercise price of \$1.30 per share represents a discount to the fair market value of our common stock on the date of grant. Because 600,000 of the discounted options are subject to Section 409A, in 2007, we established an exercise schedule to comply with Section 409A for such 600,000 options so that the options are exercisable (subject to earlier exercisability as set forth in the table below entitled "Events Affecting Option Vesting and Exercise") in four equal installments on January 1 of each of 2011, 2012, 2013 and 2014, provided that such options may be exercised only in the calendar year in which they first become exercisable, and in no event later than their expiration dates. The Employment Agreement also acknowledges the grant to Dr. Spivey of a Restricted Stock Unit Award providing for our issuance of up to 660,000 shares of our Common Stock. The Restricted Stock Unit vests one-third (1/3) upon grant and the balance in equal monthly increments on the first day of each month beginning January 1, 2006 and ending December 1, 2007. The vested shares underlying the Restricted Stock Unit Award will be issued by us on the earlier of (i) a Change in Control (as defined in our 2005 RSU Plan), or (ii) January 1, 2011. In the event of a Change in Control, we will issue the vested shares in a lump sum distribution. In the absence of a Change in Control, the issuance of the vested shares shall be made in four (4) equal installments on each of January 1, 2011, January 1, 2012, January 1, 2013 and January 1, 2014. Upon issuance of the shares underlying the Restricted Stock Unit Award, Dr. Spivey must remit to us the par value of \$0.01 per share. On December 22, 2005, the date of grant of the Restricted Stock Unit Award, the average of the closing bid and asked prices of our common stock was \$3.33, as reported by the OTCBB. Dr. Spivey has no rights as a stockholder, including no dividend or voting rights, with respect to the shares underlying the Restricted Stock Unit Award until we issue the shares. The Employment Agreement contains standard termination provisions, including upon death, disability, for Cause, for Good Reason and without Cause. In the event that we terminate the Employment Agreement without Cause or Dr. Spivey terminates the Employment Agreement for Good Reason, we are required to pay Dr. Spivey an amount equal to the bonus for such year, calculated on a pro rata basis assuming full achievement of the bonus criteria for such year (to the extent it has not already been paid), as well as Dr. Spivey's base salary for one year (such salary amount being the "Severance Pay"). In case of termination without Cause, such severance is payable in equal monthly installments over a period of twelve (12) months, and in the case of termination by Dr. Spivey for Good Reason, one-half of such severance is payable six months after termination, and the remaining half of such severance is payable thereafter in six equal monthly installments. In addition, Dr. Spivey is entitled to continued coverage under our then existing benefit plans, including medical and life insurance, for twelve (12) months from the date of termination. The Employment Agreement permits Dr. Spivey to terminate the

12

---

TABLE OF CONTENTS

Employment Agreement in the event of a Change in Control for Good Reason (as defined in the Employment Agreement), entitling Dr. Spivey to the benefits described above, except that (i) the Severance Pay is payable in a lump sum within six months after the date of termination, and (ii) options granted to Dr. Spivey vest and become exercisable as set forth in the table below entitled, "Events Affecting Option Vesting and Exercise". The Employment Agreement restricts Dr. Spivey from disclosing, disseminating or using for his personal benefit or for the benefit of

others, confidential or proprietary information (as defined in the Employment Agreement) and, provided we have not breached the terms of the Employment Agreement, from competing with us at any time prior to one year after the termination of his employment with us. In addition, Dr. Spivey has agreed not to (and not to cause or direct any person to) hire or solicit for employment any of our employees or those of our subsidiaries or affiliates (i) for six (6) months following the termination of his employment by us without Cause or by him for Good Reason, prior to a Change of Control, (ii) for twelve (12) months following the termination of his employment for Cause, prior to a Change of Control, or (iii) twenty-four (24) months following a Change of Control. The table entitled Events Affecting Option Vesting and Exercise, below, summarizes the vesting and exercisability of Dr. Spivey's options following a number of termination scenarios or a Change of Control.

Robert B. Jones will commence employment with us on April 7, 2008 (the Commencement Date) pursuant to an Employment Agreement dated March 18, 2008, which provides that Mr. Jones will serve as our Senior Vice President and Chief Operating Officer for term expiring December 31, 2009. The term of the Employment Agreement provides for automatic one (1) year renewals in the absence of written notice to the contrary from us or Mr. Jones at least ninety (90) days prior to the expiration of the initial term or any subsequent renewal period. Mr. Jones' base salary under the Employment Agreement is \$290,000. Pursuant to the Employment Agreement Mr. Jones is eligible for annual bonuses of up to thirty percent (30%) of his base salary on the achievement of such targets, conditions, or parameters as may be set from time to time by the Board of Directors or the Compensation Committee of the Board of Directors. The Employment Agreement provides for our grant to Mr. Jones of stock options exercisable for up to 30,000 shares of Common Stock at an exercise price equal to the last sale price of our common stock on the last trading day prior to the Commencement Date. The stock option provides for vesting of 1,500 shares on the last day of each month commencing May 31, 2008. The Employment Agreement also provides for the grant to Mr. Jones of a Restricted Stock Unit Award providing for our issuance of up to 50,000 shares of our Common Stock. The Restricted Stock Unit vests 2,500 shares on the last day of each month commencing May 31, 2008. The vested shares underlying the Restricted Stock Unit Award will be issued by us on the earlier of (i) a Change in Control (as defined in our 2005 RSU Plan), or (ii) January 1, 2011. In the event of a Change in Control, we will issue the vested shares in a lump sum distribution. In the absence of a Change in Control, the issuance of the vested shares shall be made in four (4) equal installments on each of January 1, 2011, January 1, 2012, January 1, 2013 and January 1, 2014. Upon issuance of the shares underlying the Restricted Stock Unit Award, Mr. Jones must remit to us the par value of \$0.01 per share. Mr. Jones has no rights as a stockholder, including no dividend or voting rights, with respect to the shares underlying the Restricted Stock Unit Award until we issue the shares. The Employment Agreement contains standard termination provisions, including upon death, disability, for Cause, for Good Reason and without Cause. In the event that we terminate the Employment Agreement without Cause or Mr. Jones terminates the Employment Agreement for Good Reason, we are required to pay Mr. Jones an amount equal to the bonus for such year, calculated on a pro rata basis assuming full achievement of the bonus criteria for such year (to the extent it has not already been paid), as well as Mr. Jones' base salary for one year (such salary amount being the Severance Pay). In case of termination without Cause and for Good Reason, such Severance Pay is payable in equal monthly installments over a period of twelve (12) months, with a six month payment delay for the that portion of the Severance Pay that would cause the payments to fall outside an exception to the deferred compensation rules requiring certain severance payments to certain officers of a public company to be made commencing six months after termination. However, if such termination without Cause or for Good Reason follows within two years of a qualifying Change of Control then the Severance Pay is payable in a lump sum 31 days after termination, otherwise if such termination follows a Change of Control by more than two years then the Severance Pay is payable six months and one day following termination. In addition, any shares remaining unvested under stock options and restricted stock units granted to Mr. Jones will vest in full upon termination without Cause or for Good Reason and Mr. Jones is entitled to continued coverage under our then existing

benefit plans, including medical and life insurance, for twelve (12) months from the date of termination. The Employment Agreement permits Mr. Jones to terminate the Employment Agreement in the event of a Change in Control for Good Reason (as defined in the Employment Agreement), entitling Mr. Jones to the benefits described above. The Employment Agreement restricts Mr. Jones from disclosing, disseminating or using for his personal benefit or for the benefit of others, confidential or proprietary information (as defined in the Employment Agreement) and, provided we have not breached the terms of the Employment Agreement, from competing with us at any time prior to one year after the termination of his employment with us. In addition, Mr. Jones has agreed not to (and not to cause or direct any person to) hire or solicit for employment any of our employees or those of our subsidiaries or affiliates (i) for six (6) months following the termination of his employment by us without Cause or by him for Good Reason, prior to a Change of Control, (ii) for twelve (12) months following the termination of his employment for Cause, prior to a Change of Control, or (iii) twenty-four (24) months following a Change of Control. The table entitled Events Affecting Option Vesting and Exercise, below, summarizes the vesting and exercisability of Mr. Jones' options following a number of termination scenarios or a Change of Control. Peter A. Clemens is employed pursuant to an Employment Agreement effective as of March 10, 1998, as amended, which provides that Mr. Clemens will serve as our Senior Vice President and Chief Financial Officer for a term expiring December 31, 2008. The term of the Employment Agreement provides for automatic one (1) year renewals in the absence of written notice to the contrary from the Company or Mr. Clemens at least ninety (90) days prior to the expiration of any renewal period. Mr. Clemens' current base salary under the Employment Agreement is \$205,000 (increased from \$180,000 effective January 1, 2008). Under the Employment Agreement, he may also receive an annual bonus to be determined based on the satisfaction of such targets, conditions or parameters as may be determined from time to time by the Compensation Committee of the Board of Directors. In 2007, Mr. Clemens was awarded a bonus of \$180,000 due to, among other reasons, the completion of our Unit Offering and the King Agreement. The Employment Agreement also provides for the grant of stock options on March 10, 1998 to purchase 30,000 shares of our common stock at an exercise price of \$23.75 per share, which options vest in equal increments of 2,500 option shares at the end of each quarterly period during the term of the Employment Agreement (as such vesting schedule may be amended by mutual agreement of Mr. Clemens and the Board of Directors). In addition, in August 2004, the Company granted stock options to Mr. Clemens to purchase 37,500 shares of Common Stock at an exercise price of \$1.30 per share, which exercise price represents a discount to the fair market value of our common stock on the date of grant. Such stock options vest in four equal portions at the end of each annual period commencing March 9, 2005. Such stock options are exercisable (subject to earlier exercisability as set forth in the table below entitled Events Affecting Option Vesting and Exercise ) in four equal installments on January 1 of each of 2011, 2012, 2013 and 2014, provided that such options may be exercised only in the calendar year in which they first become exercisable, and in any event no later than their respective expiration dates. The Employment Agreement also acknowledges the grant to Mr. Clemens of a Restricted Stock Unit Award providing for our issuance of up to 440,000 shares of our Common Stock. The Restricted Stock Unit vests one-third (1/3) upon grant and the balance in equal monthly increments on the first day of each month beginning January 1, 2006 and ending December 1, 2007. We will issue the vested shares underlying the Restricted Stock Unit Award on the earlier of (i) a Change in Control (as defined in our 2005 RSU Plan), or (ii) January 1, 2011. In the event of a Change in Control, we will issue the vested shares in a lump sum distribution. In the absence of a Change in Control, our issuance of the vested shares shall be made in four (4) equal installments on each of January 1, 2011, January 1, 2012, January 1, 2013 and January 1, 2014. Upon issuance of the shares underlying the Restricted Stock Unit Award, Mr. Clemens must remit to us the par value of \$0.01 per share. On December 22, 2005, the date of grant of the Restricted Stock Unit Award, the average of the closing bid and asked prices of our common stock was \$3.33, as reported by the OTCBB. Mr. Clemens has no rights as a stockholder, including no dividend or voting rights, with respect to the shares underlying the Restricted Stock Unit Award until we issue the shares. The Employment Agreement contains standard termination provisions, including upon death, disability, for Cause, for Good Reason and without Cause. In the event the Employment Agreement is terminated by us without Cause or by Mr. Clemens for Good Reason, we are required to pay Mr. Clemens an amount equal to \$310,000 or twice his then base salary, whichever is greater, payable in the case of termination without Cause in a lump sum within 30 days following termination and in the case of termination for Good Reason, six months after termination and to

TABLE OF CONTENTS

continue to provide Mr. Clemens coverage under our then existing benefit plans, including medical and life insurance, for a term of 24 months. The Employment Agreement permits Mr. Clemens to terminate the Employment Agreement in the event of a Change in Control (as defined in the Employment Agreement), in which case he would receive the same payments as on a termination for Good Reason. The Employment Agreement also restricts Mr. Clemens from disclosing, disseminating or using for his personal benefit or for the benefit of others confidential or proprietary information (as defined in the Employment Agreement) and, provided we have not breached the terms of the Employment Agreement, from competing with us at any time prior to two years after the earlier to occur of the expiration of the term and the termination of his employment. In addition, for a period of two (2) years from and after the effective date of the termination of his employment with us (for any reason whatsoever), (i) induce or attempt to influence any employee of the Corporation or any of its subsidiaries or affiliates to leave its employ, or (ii) aid any person, business, or firm, including a supplier, a competitor, licensor or customer of or our manufacturer for the Corporation, in any attempt to hire any person who shall have been employed by us or any of our subsidiaries or affiliates within the period of one (1) year of the date of any such requested aid. The table entitled Events Affecting Option Vesting and Exercise, below, summarizes the vesting and exercisability of Mr. Clemens options following a number of termination scenarios or a Change of Control.

## EVENTS AFFECTING STOCK OPTION VESTING AND EXERCISE (FOR MESSRS. REDDICK, SPIVEY, JONES AND CLEMENS)

	Vesting of All Options	Exercisability of Options Not Subject to Section 409A	Exercisability of Options Subject to Section 409A <sup>(1)</sup>
Termination due to Death	No additional vesting	Vested options immediately exercisable for one year following termination	Vested options immediately exercisable for the lesser of (a) one year following termination or (b) the last day of the year in which they become exercisable
Termination by Company Without Cause or by Employee for Good Reason or following Change of Control (not qualifying under Section 409A)	All options fully vest	Vested options immediately exercisable for one year following termination	Vested options exercisable commencing six months after termination for the lesser of (a) one year following termination or (b) the last day of the year in which they become exercisable
Termination due to Disability	No additional vesting	Vested options immediately exercisable for one year following termination	Vested options exercisable commencing six months after termination for the lesser of (a) one year following termination or (b) the last day of the year in which they become exercisable
Termination by the Company for Cause or by executive other than for	No additional vesting	Vested options immediately exercisable for 40 days following termination	Vested options exercisable commencing six months after termination for the lesser of (a)

Good Reason

40 days thereafter or (b) the last day of the calendar year in which they first become exercisable

15

---

TABLE OF CONTENTS

	Vesting of All Options	Exercisability of Options Not Subject to Section 409A	Exercisability of Options Subject to Section 409A <sup>(1)</sup>
Change of Control, Qualifying under Section 409A <sup>(1)</sup>	Options fully vest	Vested options immediately exercisable	Vested options exercisable upon Change of Control qualifying under Section 409A during the year in which the Change of Control occurs

(1) Not applicable to Mr. Jones.  
Messrs. Seiser and Emigh are not parties to employment agreements.

## Stock Option Plans

We currently maintain three stock option plans adopted in 1995, 1998 and 2008, respectively. In the past we used, and may continue to use, stock options to attract and retain key employees in the belief that employee stock ownership and stock-related compensation devices encourage a community of interest between employees and shareholders.

### The 1995 Stock Option Plan

The 1995 Stock Option Plan was approved by our shareholders in September, 1995. As of December 31, 2007 incentive stock options ( ISO's ) to purchase 26,251 shares and non-qualified options to purchase 10,639 shares were outstanding under the 1995 Stock Option Plan. In May, 2005 the 1995 Stock Option Plan expired and the remaining shares allocated to the Plan and not then subject to outstanding stock options were terminated. The average per share exercise price for all outstanding options under the 1995 Stock Option Plan is approximately \$15.82.

### The 1998 Stock Option Plan

The 1998 Stock Option Plan was adopted by the Board of Directors in April, 1998 and approved by our shareholders in June, 1998. The 1998 Stock Option Plan permits the grant of ISO's and non-qualified stock options to purchase shares of our Common Stock. The 1998 Stock Option Plan was amended by the Board of Directors in April, 1999 to increase the number of shares available for the grant of options under the Plan from 260,000 to 360,000 shares. Our shareholders ratified the Plan amendment on August 19, 1999. The 1998 Stock Option Plan was further amended by Board of Directors in April, 2001 to increase the number of shares available for grant of options under the Plan from 360,000 to 810,000 shares. Our shareholders ratified the Plan amendment on June 14, 2001. The 1998 Stock Option Plan was further amended by the Board of Directors on May 5, 2004 to increase the number of shares available for grant of options under the Plan from 810,000 to 2,000,000 shares. Our shareholders ratified the Plan amendment on August 12, 2004. The 1998 Stock Option Plan was further amended on February 8, 2006 to make such plan compliant with Section 409A of the Internal Revenue Code, as amended. Our shareholders ratified the amendment on December 14, 2006. As of December 31, 2007, stock options to purchase 1,821,609 shares of Common Stock had been granted

under the 1998 Stock Option Plan. Of such option grants, 85,982 are ISOs and 1,735,627 are non-qualified options. The average per share exercise price for all outstanding options under the 1998 Stock Option Plan is approximately \$2.27. No exercise price of an ISO was set at less than 100% of the fair market value of the underlying Common Stock. The exercise price of non-qualified options exercisable for 1,699,414 shares of common stock has been set at less than the fair market value on the date of grant of the underlying Common Stock. Subject to the terms of the 1998 Stock Option Plan, the Board of Directors, or a Committee appointed by the Board determines the persons to whom grants are made and the vesting, timing, amounts and other terms of such grant. An employee may not receive ISO's exercisable in any one calendar year for shares with a fair market value on the date of grant in excess of \$100,000. No quantity limitations apply to the grant of non-qualified stock options.

Options issued to date at a discount under the 1998 Stock Option Plan, which had not vested as of December 31, 2004, are exercisable (subject to earlier exercise as described below) in four equal installments

16

### TABLE OF CONTENTS

on January 1 of each of 2011, 2012, 2013 and 2014. These options are exercisable earlier than stated above upon a qualifying change of control and upon termination of employment (generally for a period of 90 days), subject in the case of termination, to a 6 month waiting period prior to exercise for Messrs Reddick, Clemens, Spivey, Seiser and Emigh.

In April 2008 the 1998 Stock Option Plan will expire and the remaining shares allocated to the Plan and not then subject to outstanding stock options will terminate.

See Events Affecting Option Vesting and Exercise above for the vesting and exercise of options granted to Messrs. Reddick, Spivey, Jones and Clemens.

### **The 2008 Stock Option Plan**

See Proposal 2 for a discussion of the 2008 Stock Option Plan.

### **Restricted Stock Unit Award Plan**

See Proposal 3 for a description of the 2005 Restricted Stock Unit Award Plan.

## **Outstanding Equity Awards at 2007 Year End and Option Exercises in 2007**

The following table presents information regarding outstanding stock awards at December 31, 2007 for each of the named executive officers. All RSU awards granted to named executive officers had vested at December 31, 2007.

### **Outstanding Equity Awards at 2007 Year-End**

Name	Option Awards		Option	Option
	Number of	Number of	Exercise	Expiration Date
	Securities	Securities		



	Underlying Unexercised Options (#) Exercisable	Underlying Unexercised Options (#) Unexercisable	Price (\$)	
Andrew D.Reddick	875,000		\$1.30	08/12/2014
	30,000		\$23.75	02/19/2008
	10,000		\$11.25	03/08/2009
Peter A. Clemens	12,500		\$18.75	02/17/2010
	10,000		\$11.125	06/29/2010
	28,125	9,375	\$1.30	03/09/2014
Ron J. Spivey	300,000		\$1.30	04/15/2014
	400,000		\$1.30	12/09/2015
	4,000		\$25.00	05/29/2008
	1,600		\$11.25	03/08/2009
Robert A. Seiser	3,000		\$18.75	02/17/2010
	4,000		\$11.125	06/29/2010
	2,500		\$24.60	11/15/2011
	18,675	6,225	\$1.30	03/09/2014
	1,000		\$25.00	05/29/2008
	1,000		\$15.00	10/13/2008
	1,600		\$11.25	03/08/2009
James F. Emigh	5,000		\$18.75	02/17/2010
	4,000		\$11.125	06/29/2010
	2,500		\$24.60	11/15/2011
	18,675	6,225	\$1.30	03/09/2014

The following table presents information regarding the value realized on the vesting during 2007 of RSU awards to the named executive officers. No stock options were exercised by the named executive officers during 2007.

17

## TABLE OF CONTENTS

# RSUs VESTED IN FISCAL YEAR 2007

Name	RSU Awards	
	Number of Shares Vested (#) <sup>(1)</sup>	Value Realized on Vesting (\$) <sup>(2)</sup>
Andrew D. Reddick	275,000	\$ 3,331,625
Peter A. Clemens	146,667	1,776,859
Ron J. Spivey	220,000	2,665,300
James F. Emigh	45,833	555,267
Robert A. Seiser	55,000	666,325

(1) The vested shares underlying the RSUs will be issued by us on the earlier of (i) a Change of Control (as defined in our 2005 Restricted Stock Unit Award Plan), or (ii) in four annual installments starting on January 1, 2011. In the event of a Change of Control, our issuance of the vested shares shall be made in a lump sum distribution. In the absence of a Change of Control, the issuance of the vested shares shall be issued in four (4) equal installments on each of January 1, 2011, January 1, 2012, January 1, 2013 and January 1, 2014. Upon our distribution of the vested

shares underlying the RSUs, the recipients must submit to us the par value of \$0.01 per share. The recipients of the RSUs have no rights as a stockholder, including no dividend or voting rights, with respect to the shares underlying such awards until the shares are issued by us.

Value is determined by subtracting the \$.01 par value required to be paid on exchange of each share for RSUs from (2) the closing price of our Common Stock on the OTCBB on each vesting date and multiplying the result by the number of shares underlying the RSUs that vested on such date and then aggregating those results.

## Securities Authorized for Issuance Under Equity Compensation Plans

The following table includes information as of December 31, 2007 relating to our 1995 and 1998 Stock Option Plans and our 2005 Restricted Stock Unit Award Plan, which comprised all of our equity compensation plans, pursuant to which awards have been made as of the date of this Proxy Statement. The table provides the number of securities to be issued upon the exercise of outstanding options and distributions under outstanding Restricted Stock Unit Awards under such plans, the weighted-average exercise price of outstanding options and the number of securities remaining available for future issuance under such equity compensation plans:

### Equity Compensation Plan Information

Plan Category	Number of Securities to Be Issued upon Exercise of Outstanding Options, Warrants and Rights (a)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a) (c)
Stock Option Equity Compensation Plans Approved by Security Holders	1,858,499	\$ 2.53	102,666
Stock Option Equity Compensation Plans Not Approved by Security Holders	0	0	0
Restricted Stock Unit Equity Compensation Plans Approved by Security Holders	2,950,000	0.01	50,000
Restricted Stock Unit Equity Compensation Plans Not Approved by Security Holders	0	0	0
Total	4,808,499	\$ 0.99	152,666

18

---

#### TABLE OF CONTENTS

## Potential Payments upon Termination or Change in Control

### Messrs. Emigh and Seiser

*Options.* If a change of control occurs (which constitutes a change of control under the stock option agreements) previously unvested options vest with respect to all underlying shares (relating to 6,225 shares for each of Messrs. Emigh and Seiser, as of December 31, 2007). Messrs. Emigh and Seiser would realize a benefit of \$442 and \$442, respectively, from such option vesting if such change of control had occurred on December 31, 2007. Upon the occurrence of a change of control that meets the requirements of Section 409A of the Internal Revenue Code stock options granted to each of Messrs. Emigh and Seiser to purchase 24,900 shares of common stock become exercisable in full.

*RSUs.* As of December 31, 2007, all RSUs granted to Messrs. Emigh and Seiser had vested. Upon the occurrence of a change of control that meets the requirements of Section 409A of the Internal Revenue Code, the RSUs are fully distributable for shares upon payment of the \$.01 par value per share, instead of under their normal distribution schedule.

The dollar benefits described above are the compensation cost for such awards that would have been recognized in 2007 in our financial statements in accordance with FAS 123R, had such accelerated vesting/distribution occurred.

### Messrs. Reddick, Spivey and Clemens

Based upon a hypothetical triggering date of December 31, 2007, the quantifiable benefits for Messrs. Andrew Reddick, Peter Clemens and Ron Spivey upon a termination/change of control would have been as set forth the table below:

Triggering Event	Executive	Severance	Bonus	Value of Options Vesting <sup>(4)</sup>	Medical, Dental, Health, Disability and Life Insurance Benefits	Total <sup>(7)</sup>
Termination by Company without Cause or by Employee for Good Reason or after a Change of Control	Andrew D. Reddick	300,000 <sup>(1)(8)</sup>	(3)	(5)	26,270 <sup>(6)</sup>	326,270
	Ron J. Spivey	260,000 <sup>(1)(9)</sup>	(3)	(5)	7,875 <sup>(6)</sup>	267,875
	Peter A. Clemens	360,000 <sup>(2)(10)</sup>	(3)	666	52,540 <sup>(11)</sup>	413,206
Termination for Death	Andrew D. Reddick		(3)			
	Ron J. Spivey					
Termination for Disability	Peter A. Clemens					
	Andrew D. Reddick		(3)			
	Ron J. Spivey					

	Peter A. Clemens		
	Andrew D. Reddick		
Termination with Cause	Ron J. Spivey		
	Peter A. Clemens		
	Andrew D. Reddick	(5)	
Change of Control Without Termination	Ron J. Spivey	(5)	
	Peter A. Clemens	666	666

The terms Change of Control , Cause , and Good Reason have the meanings in the listed executive s employment agreements.

(1) In the case of termination without Cause, payable in 12 monthly installments. In the case of termination for Good Reason, one half of amount is payable six months and one day after termination, and remaining amount is payable thereafter in six monthly installments. In the case of termination after a Change of Control, amount is payable in a lump sum six months and one day after termination.

(2) In the case of termination without Cause, payable in a lump sum within 30 days after termination. In the case of termination for Good Reason and termination after Change of Control, amount is payable in a lump sum six months and one day after termination.

19

---

TABLE OF CONTENTS

- (3) Payable in a lump sum within 30 days after termination. Because bonuses were paid prior to December 31, 2007, named executives would not have been entitled to any additional bonuses upon termination at December 31, 2007. The dollar amount reported is the compensation cost for such awards that would have been recognized in 2007 in our financial statements in accordance with FAS 123R had the unvested stock options at December 31, 2007 vested at such date. See Employment Agreements for a description of the exercise periods following termination.
- (4) Messrs. Reddick and Spivey have no outstanding unvested options. See Employment Agreements for discussion of option vesting and exercisability upon termination.
- (5) Represents the value of medical, dental, disability and life insurance for the twelve months following termination and a tax gross up for such amounts. Payable in lump sum within 30 days after termination. Assumes executive has selected lump sum payment option, in lieu of continued benefits. This amount is estimated.
- (6) (7) Excludes accrued vacation.
- (8) Represents one year of salary, at the rate in effect on December 31, 2007. Effective January 1, 2008, Mr. Reddick s salary was increased to \$365,000 per annum.
- (9) Represents one year of salary, at the rate in effect on December 31, 2007. Effective January 1, 2008, Mr. Spivey s salary was increased to \$315,000 per annum.
- (10) Represents two years of base salary, at the rate in effect on December 31, 2007. Effective January 1, 2008, Mr. Clemens salary was increased to \$205,000 per annum.
- (11) Represents the estimated value of medical, dental, disability and life insurance for the twenty-four months following termination. Payable in lump sum within thirty days after termination.

## Director Compensation

The following table sets forth a summary of the compensation paid by us to our Directors (other than Andrew Reddick, whose compensation, is reflected in the Summary Compensation Table) for services rendered in all capacities to us during the fiscal year ended December 31, 2007:

### 2007 Director Compensation

Director	Fees Earned or Paid in Cash (\$)	Stock Awards (\$) <sup>(1)</sup>	Option Awards (\$) <sup>(2)</sup>	Total (\$)
William G. Skelly	11,500			11,500
William A. Sumner	12,000			12,000
Bruce F. Wesson	5,250			5,250
Richard J. Markham	6,250			6,250
Immanuel Thangaraj		(3)		

(1) Messrs. Skelly and Sumner each held fully vested RSUs with respect to 100,000 underlying shares, as of December 31, 2007. Messrs. Wesson, Markham and Thangaraj held no RSUs. The dollar amount provided is the compensation cost for such awards recognized in 2007 is as reported in our financial statements in accordance with FAS 123R.

(2) Messrs. Skelly, Sumner, Wesson, Markham and Thangaraj, held vested options with respect to 29,000, 5,000, 15,000, 0 and 10,000 underlying shares, respectively, as of December 31, 2007. The dollar amount provided is the compensation cost for such awards recognized in 2007 is as reported in our financial statements in accordance with FAS 123R.

(3)

Fee waived.

Under the Director compensation program in effect in 2006 and 2007, non-employee Directors received \$500 for each meeting attended (\$250 in the case of telephonic meetings) and non-employee Directors who served on any of the Committees established by the Board of Directors received \$250 for each Committee meeting attended unless held on the day of a full Board meeting. Non-employee Directors were eligible to receive, at the discretion of the Board, an annual grant of options to purchase 5,000 shares of our common stock. No such option grants were made to any Director in 2006 or 2007. We also reimbursed Directors for travel and lodging expenses, if any, incurred in connection with attendance at Board meetings.

20

#### TABLE OF CONTENTS

In January 2008, in order to retain and attract qualified directors, our Board amended the Director compensation program to provide for a \$20,000 annual retainer for each non-employee Director (and an additional annual retainer of \$5,000 for the chairperson of the Audit Committee and \$2,500 for each other Committee chairperson), a \$1,000 fee for each Board meeting attended in person (\$500 if attended telephonically), and a \$500 fee for each Committee meeting attended (\$250 if attended telephonically). The annual retainer fees are payable in four equal installments at the end of each calendar quarter during the year. In addition, non-employee Directors will receive an annual grant of options to purchase 15,000 shares of our common stock. The stock options have a term of 10 years and have an exercise price equal to the closing price of our common stock on the first trading day of the year of grant as reported by the NASDAQ Capital Market, except in the case of the stock option grants for 2008, in which case the exercise price was equal to the last sale price for our common stock on January 24, 2008 (the date of adoption by the Board of

the new board compensation program) as reported by the OTC Bulletin Board. The stock options vest in equal installments at the end of each calendar quarter during the year of grant. Directors who are also our employees receive no additional or special remuneration for their services as Directors. We also continue to reimburse Directors for travel and lodging expenses, if any, incurred in connection with attendance at Board meetings.

In addition, on February 11, 2006, we granted to each of Messrs. William Sumner and William Skelly Restricted Stock Unit Awards providing for our issuance of up to 100,000 shares of our common stock. The Restricted Stock Unit Awards are made pursuant to our 2005 Restricted Stock Unit Award Plan and were in consideration of the services provided to us by Messrs. Sumner and Skelly as independent members of the Board and as representatives of the Independent Committee of the Board of Directors for various material transactions undertaken by us during the period 2002 through 2005, including, without limitation, our debenture offerings in 2002 and 2004, the conversion of our preferred stock into common stock and various bridge loans financing transactions, as well as for their continued service as directors of the Company. The Restricted Stock Unit Awards to each of Messrs. Sumner and Skelly vested 38,889 shares on grant and the balance vest in equal monthly installments on the first day of each month beginning March 1, 2006 and ending December 1, 2007. The vested shares underlying the Restricted Stock Unit Awards will be issued by us on the earlier of (i) a Change in Control (as defined in our 2005 Restricted Stock Unit Award Plan), or (ii) in four annual installments starting on January 1, 2011. In the event of a Change in Control, we will issue the vested shares underlying the Restricted Stock Unit Award in a lump sum distribution. In the absence of a Change in Control, the issuance of the vested shares shall be made in four (4) equal installments on each of January 1, 2011, January 1, 2012, January 1, 2013 and January 1, 2014. Upon the issuance of the vested shares underlying the Restricted Stock Unit Awards, Messrs. Sumner and Skelly must pay us the \$0.01 par value per share.

## Compensation Committee Interlocks and Insider Participation

During 2007 our Compensation Committee consisted of Messrs. Markham, Skelly and Reddick. Except for Mr. Reddick, who is our President and Chief Executive Officer, there were no Compensation Committee interlocks or insider participation in compensation decisions. See Employment Agreements for a discussion of Mr. Reddick's employment agreement.

## Compensation Committee Report

The following report of the Compensation Committee is not deemed to be soliciting material or to be filed with the Commission or subject to Regulation 14A or 14C [17 CFR 240.14a-1 *et seq.* or 240.14c-1 *et seq.*], other than as specified, or to the liabilities of Section 18 of the Exchange Act [15 U.S.C. 78r].

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis in this Report with Company management. Based on such review and discussions, the Compensation Committee recommended to the Board of Directors that the Compensation Discussion and Analysis be included in this Report.

Richard J. Markham, Bruce F. Wesson and Immanuel Thangaraj.

---

### TABLE OF CONTENTS

## 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 beneficially more than ten percent (10%) of our Common Stock, to file reports of ownership and

changes of ownership with the SEC. Copies of all filed reports are required to be furnished to us pursuant to Section 16(a). Based solely on the reports received by us and on written representations from reporting persons, we believe that our Directors, executive officers and greater than ten percent (10%) beneficial owners of our Common Stock complied with all Section 16(a) filing requirements during the year ended December 31, 2007, except as noted below.

GCE Holdings LLC filed a late Form 3 and reported late on Form 4 the conversion of preferred stock into common stock in 2005. Essex Woodlands Health Ventures Fund V, LP reported late on three Form 4s relating to the conversion by GCE Holdings LLC of preferred shares to common stock in 2005, the receipt of common stock in satisfaction of interest payments on outstanding notes in 2005, 2006 and 2007, and the receipt of a warrant to purchase common stock in 2004. Immanuel Thangaraj, as a managing partner of Essex Woodlands Health Ventures Fund V, LP, disclaimed beneficial ownership of securities held by Essex Woodlands Health Ventures V, LP (except to the extent of his pecuniary interest therein) but reported late on three Form 4s relating to the above described transactions of Essex Woodlands Health Ventures Fund V, LP. To the extent, Galen Partners III, L.P., Galen Partners International, III, L.P., Galen Employee Fund III, L.P., Care Capital Offshore Investments II, LP and Care Capital Investments II, LP are deemed to own beneficially the shares of the Company's Common Stock held by GCE Holdings LLC or are members of a group which in the aggregate are deemed to own beneficially ten percent or more of the Company's Common Stock, they should have each filed Form 4s with respect to the receipt of common stock in satisfaction of interest payments on outstanding notes in 2007.

## **Certain Relationships and Related Transactions and Director Independence**

### **Certain Relationships and Related Transactions**

GCE Holdings LLC, our 78% stockholder ( GCE ) is the assignee of all of our shares of preferred stock (prior to their conversion into common stock) formerly held by each of Galen Partners III, L.P., Galen Partners International III, L.P., Galen Employee Fund III, L.P. (collectively, Galen ), Care Capital Investments II, LP, Care Capital Offshore Investments II, LP (collectively, Care Capital ) and Essex Woodlands Health Ventures V, L.P., ( Essex and together with Galen and Care, the VC Investors ). Galen, Care and Essex own 39.8%, 30.6% and 29.6%, respectively, of the membership interest in GCE. Messrs. Wesson, Markham and Thangaraj, each a Director, exercise investment control over the membership interests in GCE held by Galen, Care and Essex, respectively, and correspondingly exercise investment control over our common stock held by GCE.

As a condition to the completion of our 2004 debenture offering, we, the investors in our 2004 debentures and the holders of our outstanding 5% convertible senior secured debentures due March 31, 2006 issued by us during the period from 1998 through 2003 executed a certain Voting Agreement dated as of February 6, 2004 (the Voting Agreement ). The Voting Agreement provided that each of Galen, Care and Essex (collectively, the Lead 2004 Debenture Investors ) had the right to designate for nomination one member of our Board of Directors, and that the Lead Debenture 2004 Investors collectively may designate one additional member of the Board (collectively, the Designees ). In connection with the conversion of our preferred shares into common stock completed in November 2005, the Voting Agreement was amended to reflect the conveyance by each of Galen, Care and Essex of their holdings in our preferred shares (prior to their conversion into common stock) to GCE. After giving effect to a further amendment in January 2008, the Voting Agreement, as amended, provides that our Board of Directors shall be comprised of not more than seven (7) members, three (3) of whom shall be designees of GCE, one of whom shall be our CEO and three of whom shall be independent directors. The designees of GCE are Messrs. Wesson, Markham and Thangaraj.

We were a party to a certain loan agreement with each of the VC Investors and certain of our other shareholders dated February 10, 2004 (the \$5.0 Million Secured Term Note ). The \$5.0 Million Secured Term Note was in the principal

amount of \$5.0 million and was secured by a lien on all of our assets and the assets of our subsidiary. On June 28, 2007, the \$5.0 Million Secured Term Note was amended to extend the maturity date from June 30, 2007 to September 30, 2007 and further amended on August 20, 2007 to extend

22

---

TABLE OF CONTENTS

the maturity date from September 30, 2007 to December 31, 2008. In addition, the August 20, 2007 amendment to the \$5.0 Million Secured Term Note reduced the interest rate from a variable rate of prime plus 4.5%, to a fixed rate of 10.0% per annum and to provide for interest payments in the form of cash instead of our common stock. During September 2007 approximately \$8,000 of principal was repaid under the \$5.0 Million Secured Term Note leaving a principal balance of \$4,992,000. In accordance with the terms of the \$5.0 million Secured Term Note on December 7, 2007, simultaneous with our receipt of the non-refundable \$30.0 million upfront cash payment received from King under the King Agreement, we satisfied in full all of our obligations under the \$5.0 Million Secured Term Note.

During the period from June 2005 through July 2007 we borrowed an aggregate of \$10.544 million pursuant to a series of loan agreements between us, the VC Investors and certain other shareholders (the Bridge Loans). We used the net proceeds from the Bridge Loans to develop our Aversion® Technology and fund related operating expenses. The Bridge Loans carried an interest rate of 10%, payable quarterly which, pursuant a November 2006 amendment, was payable, at the Company's option, with shares of its Common Stock. The Bridge Loans, as amended in March 2007, had a scheduled maturity date of September 30, 2007. In accordance with the conversion provisions contained in the Bridge Loans, the outstanding \$10.544 million principal balance under Bridge Loans was converted into our units upon the closing of our Unit Offering described below. As a result, the Bridge Loan Agreements and all related security agreements and guaranties were terminated.

During 2007, we paid an aggregate of \$145,000 in cash interest under the Bridge Loans (of which \$47,000 was paid to each of Galen, Care and Essex) and issued an aggregate of 47,300 shares of our common stock in satisfaction of interest payments under the Bridge Loans (of which 15,300 shares were issued to each of Galen, Care and Essex)(on a post reverse stock split basis).

On August 20, 2007, we entered into a Securities Purchase Agreement with GCE Holdings LLC, our controlling shareholder, and the investors named therein (collectively, the Unit Investors ). Pursuant to the Agreement, the Unit Investors purchased in the aggregate (on a post reverse stock split basis) 2,365,185 of our Units ( Units ), at a price of \$10.80 per Unit (the Unit Offering ). Each Unit consisted of four shares of common stock and a warrant to purchase one share of common stock (the Warrants ). 1,388,889 of the Units were issued for cash, with the balance of 996,296 Units issued to GCE Holdings LLC, as assignee of the Bridge Loans from the VC Investors, in consideration of the conversion of an aggregate of \$10.544 million in principal amount under our outstanding Bridge Loans. The net cash proceeds to us after expenses of the Unit Offering were approximately \$14.2 million.

The Warrants issued in the Unit Offering are immediately exercisable at a price of \$3.40 per share (on a post reverse stock split basis) and expire August 20, 2014. The Warrants may be exercised for cash, or on a cashless basis commencing 180 days after the closing if at the time of exercise the shares underlying the Warrants are not covered by an effective registration statement filed with the SEC.

At the time of issuance, the common stock and shares of common stock underlying the Warrants sold pursuant to the Unit Offering were not registered under the Securities Act of 1933, as amended, and may not be offered or sold in the United States in the absence of an effective registration statement or exemption from registration requirements. In accordance with the requirements of the Securities Purchase Agreement, we filed a registration statement with the SEC for purposes of registering the resale of the shares of common stock issued as part of the Units and the shares of common stock issuable upon exercise of the Warrants (the Registration Statement ). The Registration Statement was



declared effective by the SEC on November 20, 2007. We must exercise best efforts to keep the Registration Statement effective until the earlier of (i) the date that all shares of common stock and shares of common stock underlying Warrants covered by the Registration Statement have been sold, or (ii) the fifth anniversary of the Registration Statement, provided that the period during which the Registration Statement must be kept effective can be shortened to not less than two years by agreement of holders of registrable securities. Shares of common stock eligible for sale under Rule 144(k) of the Securities Act of 1933, as amended, need not be included in the Registration Statement. Under certain circumstances, if shares are excluded from the Registration Statement by the SEC, we may be required to file one or more additional Registration Statements for the excluded shares.

23

---

## TABLE OF CONTENTS

Subject to certain exceptions, for each day that we fail to keep the Registration Statement effective, we must pay each Investor 0.05% of the purchase price of securities covered by the Registration Statement and held by such Unit Investor at such time, up to a maximum of 9.9% of the amount paid by a Unit Investor for the Units.

The requirement in the Securities Purchase Agreement to file the Registration Statement triggered the piggyback registration rights granted to certain holders of shares of our common stock and warrants exercisable for common stock pursuant to an Amended and Restated Registration Rights Agreement dated as of February 6, 2004, as amended. GCE Holdings LLC, Galen Partners III, L.P., Galen Partners International III, L.P., Galen Employee Fund III, L.P., Care Capital Investments II, LP, Care Capital Offshore Investments II, LP and Essex Woodlands Health Ventures V, L.P. exercised their piggyback registration rights under such Agreement. As a result, an aggregate of 26,584,016 shares of common stock and shares underlying warrants held by such shareholders (after giving effect to our 1 for 10 reverse stock split effected December 5, 2007) were included in the Registration Statement.

Our Board has not adopted formalized written policies and procedures for the review or approval of related party transactions. As a matter of practice, however, our Board has required that all related party transactions, including, without limitation, each of the transactions described above in this Item 13, be subject to review and approval by a committee of independent directors established by the Board. The Board's practice is to evaluate whether a related party (including a director, officer, employee, GCE Holdings, Galen, Care, Essex or other significant shareholder) will have a direct or indirect interest in a transaction in which we may be a party. Where the Board determined that such proposed transaction involves a related party, the Board formally establishes a committee comprised solely of independent directors to review and evaluate such proposed transaction (the Independent Committee). The Independent Committee is authorized to review any and all information it deems necessary and appropriate to evaluate the fairness of the transaction to us and our shareholders (other than the interested related party to such transaction), including meeting with management, retaining third party experts (including counsel and financial advisors if determined necessary and appropriate by the Independent Committee) and evaluating alternative transactions, if any. The Independent Committee is also empowered to negotiate the terms of such proposed related party transaction on our behalf. The proposed related party transaction may proceed only following the approval and recommendation of the Independent Committee. Following the Independent Committee's approval, the related party transaction is subject to final review and approval of the Board as a whole, with any interested director abstaining from such action.

Each of the transactions described above in this section were subject to the review, evaluation, negotiation and approval of an Independent Committee of the Board. In each of such case, the Independent Committee was comprised of Messrs. Sumner and Skelly.

## **Director Independence**

In assessing the independence of our Board members, our Board has reviewed and analyzed the standards for independence required under the NASDAQ Capital Market, including NASDAQ Marketplace Rule 4200(a)(15), and applicable SEC regulations. Based on this analysis, our Board has determined that each of Messrs. William A. Sumner, William Skelly and George Ross meet the standards for independence provided in the listing requirements of the NASDAQ Capital Market and SEC regulations. As a result, three of our seven Board members meet such standards of independence. Although the listing standards of the NASDAQ Capital Market specify that a majority of a listed issuer's board of directors must be comprised of independent directors, we are relying upon an exemption for controlled companies provided in the listing standards for the NASDAQ Capital Market. A controlled company is a company of which more than 50% of the voting power is held by an individual, a group or another company. Based on GCE Holdings LLC's ownership of approximately 78% of our common stock, we are considered a controlled company under the rules of the NASDAQ Capital Market and are relying upon this exemption in having less than a majority of independent directors on our Board.

With respect to our Board committees, our Board has determined that the members of our Compensation Committee do not meet the standards for independence described above.

24

---

TABLE OF CONTENTS

## **Vote Required and Board Recommendation**

Directors are elected by a plurality of the votes cast. The seven candidates receiving the highest number of votes will be elected as directors.

The Board of Directors recommends that the shareholders vote **FOR** each of the above nominees for Director.

25

---

TABLE OF CONTENTS

## **PROPOSAL 2**

# **RATIFICATION OF THE ADOPTION OF THE COMPANY'S 2008 STOCK OPTION PLAN**

On March 14, 2008, the Board of Directors adopted our 2008 Stock Option Plan (the "2008 Plan"). A copy of the 2008 Plan, for which ratification is sought, is set forth in **Appendix A** to this Proxy Statement. The 2008 Plan is effective as of the date of adoption by the Board. The 2008 Plan allows for the grant of stock options to our employees, officers, Directors and consultants. Approximately 20 employees, officers and directors were eligible to participate in the 2008 Plan as of the date of this Proxy Statement.

The Board of Directors believes that it would be in our best interests for our shareholders to ratify the adoption of the 2008 Plan. No stock options have been granted under the 2008 Plan pending shareholder ratification.

The 2008 Plan is intended to assist us in securing and retaining key employees and Directors by allowing them to participate in our ownership and growth through the grant of incentive stock options ("ISOs"), as defined in Section 422

of the Code, or non-qualified stock options to which Section 422 of the Code does not apply (collectively, the Options ). The granting of Options serves as partial consideration for and gives key employees, Directors and consultants an additional inducement to, remain in our service and will provide them with an increased incentive to work for our success.

We currently maintain a 1995 Stock Option Plan and a 1998 Stock Option Plan. See Compensation of Executive Officers and Directors Stock Option Plans. As of the date of this Proxy Statement, ISO's to purchase 26,251 shares and non-qualified options to purchase 10,639 shares were granted and outstanding under the 1995 Stock Option Plan, and options to purchase an aggregate of 15,046 shares had been exercised. As of the date of this Proxy Statement, ISO's to purchase 85,982 shares and non-qualified options to purchase 1,735,627 shares were granted and outstanding under the 1998 Stock Option Plan, and options to purchase an aggregate of 75,725 shares had been exercised. In May, 2005 the 1995 Stock Option Plan expired and the remaining unissued shares allocated to the Plan were terminated. In April 2008 the 1998 Stock Option Plan expired and the remaining unissued shares allocated to the Plan were terminated.

The following discussion of the principal features and effects of the 2008 Plan is qualified in its entirety by reference to the text of the 2008 Plan, set forth in **Appendix A** attached hereto.

## **Administration**

The 2008 Plan is administered by the Board of Directors. The Board of Directors selects the employees, directors and consultants to be granted Options under the 2008 Plan and, subject to the provisions of the 2008 Plan, determines the terms and conditions and number of shares subject to each Option.

## **Shares Subject to the 2008 Plan**

The 2008 Plan authorizes the granting of either ISOs or non-qualified stock options to purchase in the aggregate up to 6,000,000 shares of the Company's Common Stock. The shares available for issuance will be increased or decreased according to any reclassification, recapitalization, stock split, stock dividend or other such subdivision or combination of our Common Stock. Shares of our Common Stock subject to unexercised Options that expire or are terminated prior to the end of the period during which Options may be granted under the 2008 Plan will be restored to the number of shares available for issuance under the 2008 Plan. As of the date of this Proxy Statement no stock options had been granted under the 2008 Plan and 6,000,000 shares of Common Stock remained available for the grant of Options under the 2008 Plan.

## **Eligibility**

Any of our employees or employees of our subsidiary shall be eligible to receive ISOs and non-qualified stock options under the 2008 Plan. Non-qualified stock options may be granted to employees as well as non-employee directors and consultants under the 2008 Plan as determined by the Board. Any person who has been granted an Option may, if he is otherwise eligible, be granted an additional Option or Options.

Each grant of an Option shall be evidenced by an Option Agreement, and each Option Agreement shall (i) specify whether the Option is an ISO or a non-qualified stock option and (ii) incorporate such other terms

and conditions as the Board of Directors acting in its absolute discretion deems consistent with the terms of the 2008 Plan, including, without limitation, a restriction on the number of shares of Common Stock subject to the Option which first become exercisable during any calendar year.

To the extent that the aggregate fair market value of the Common Stock of the Company underlying a grant of ISOs (determined as of the date such an ISO is granted), which first become exercisable in any calendar year, exceeds \$100,000, such Options shall be treated as non-qualified stock options. This \$100,000 limitation shall be administered in accordance with the rules under Section 422(d) of the Code.

Not more than 600,000 shares may be subject to an Option award made to an individual in any calendar year.

## Exercise Price of Options

Upon the grant of an Option to an employee, director or consultant the Board will fix the number of shares of Common Stock that the optionee may purchase upon exercise of the Option and the price at which the shares may be purchased. The Option exercise price for ISOs shall not be less than the fair market value of the Common Stock at the time the Option is granted, except that the Option exercise price shall be at least 110% of the fair market value where the Option is granted to an employee who owns more than 10% of the voting power of all of our classes of stock or any parent or subsidiary. Under the terms of the 2008 Plan, the aggregate fair market value of the stock (determined at the time the Option is granted) with respect to which ISOs are exercisable for the first time by such individual during any calendar year shall not exceed \$100,000. The Option exercise price for non-qualified stock options granted under the 2008 Plan may be less than the fair market value of our Common Stock ( Discounted Options ). Fair market value is the closing price of the common stock as reported in the financial press (or if no such quote is available, as determined by the Board of Directors). On March 25, 2008, the closing price of our Common Stock on the Nasdaq Capital Market was \$9.02 per share.

## Terms

All Options available to be granted under the 2008 Plan must be granted by March 13, 2018. The Board will determine the actual term of the Options but no Option will be exercisable after the expiration of 10 years from the date of grant. No ISO granted to an employee who owns more than 10% of the combined voting power of all of our outstanding classes of stock may be exercised after five years from the date of grant.

The Options granted pursuant to the 2008 Plan shall not be transferable except by will or the laws of descent and distribution; provided that the Board in its sole discretion, may permit limited transferability, from time to time, on a general or specific basis, and may impose conditions and limitations on any permitted transferability.

## Exercise of Options

Options granted to employees, directors or consultants under the 1998 Plan may be exercised during the optionee's lifetime only by the optionee during his employment or service with us or for a period not exceeding one year if the optionee ceased employment or service as a director or consultant because of permanent or total disability within the meaning of Section 22(e)(3) of the Code. Options may be exercised by the optionee's estate, or by any person who acquired the right to exercise such Option by bequest or inheritance from the optionee for a period of twelve months from the date of the optionee's death. If such Option shall by its terms expire sooner, such Option shall not be extended as a result of the optionee's death.

The consideration to be paid to us upon exercise of an Option may consist of any combination of cash, checks, promissory notes (subject to the provisions of the Sarbanes-Oxley Act of 2002, prohibiting loans to executive officers

and directors), shares of Common Stock, and/or any other forms of consideration permitted under New York law and approved by the Board of Directors. With the exception of the consideration received by us upon the exercise of Options granted under the 2008 Plan, no consideration is received by us for the granting or extension of any Options.

As a result of Section 409A of the Internal Revenue Code of 1986, as amended ( Section 409A ), Discounted Options, and other Options that the Board determines will be subject to Section 409A (subject to

27

---

## TABLE OF CONTENTS

certain exceptions, Options with an Option exercise price equal to fair market value on the date of grant are generally not subject to Section 409A) will be subject to special exercisability rules. Generally, they may become exercisable only upon one or more of the following events:

(i) the optionee's separation from service (or six months thereafter for certain specified employees),

(ii) the date the optionee becomes disabled (as defined in Treasury regulations),

(iii) the optionee's death,

(iv) a specified time (or pursuant to a fixed schedule) specified under the Option grant agreement at the date of the grant of the Option,

(v) to the extent provided by the Secretary of the Treasury, a change in the ownership or effective control of the Company or a Subsidiary, or in the ownership of a substantial portion of the assets of the Company or a Subsidiary, or

(vi) the occurrence of an unforeseeable emergency (as defined in the Treasury Regulations) with respect to the optionee.

Exercisability is distinct from vesting, as Options may be fully vested, although not yet exercisable.

## **Federal Income Tax Consequences Relating to Incentive Stock Options**

Certain Options granted under the 2008 Plan are intended to qualify as incentive stock options within the meaning of Section 422 of the Code. Set forth below is a discussion of all relevant Federal income tax consequences to participants and us of incentive stock options granted under the 2008 Plan.

An employee to whom an incentive stock option is granted pursuant to the 2008 Plan will not recognize any compensation income at the time an incentive stock option is granted or at the time an incentive stock option is exercised. In the year of exercise, however, the amount by which the fair market value of the Common Stock exceeds the Option exercise price will be included as a positive adjustment in the calculation of the optionee's alternative minimum taxable income in the year of exercise. The alternative minimum tax imposed on individual taxpayers is generally equal to the amount by which 28% (26% of alternative minimum tax income below certain amounts) of the individual's alternative minimum tax income (reduced by certain exemption amounts) exceeds his or her regular income tax liability for the year. If the optionee incurs minimum tax in the year of exercise, however, he should qualify for the credit for prior year maximum tax liability in the first future year he has regular tax liability.

In general, neither the exercise of an incentive stock option nor the sale of any Common Stock acquired under the incentive stock option will have any tax consequences to us. However, we will generally be entitled to a business-expense deduction with respect to any ordinary compensation income recognized by an optionee, including as a result of a disqualifying disposition of the Common Stock acquired under the incentive stock option (discussed in the following paragraph), at the same time that the optionee recognizes ordinary income compensation.

In order to obtain incentive stock option treatment for Federal income tax purposes upon the subsequent sale (or other disposition) by the optionee of the shares of Common Stock received upon exercise of the Option, the sale (or other disposition) must not occur within two years from the date the Option was granted nor within one year after the issuance of such shares upon exercise of the Option (the incentive stock option holding period requirements). If the incentive stock option holding period requirements are satisfied, on the subsequent sale (or other disposition) by the optionee of the shares of Common Stock received upon the exercise of an Option, the optionee generally will recognize income from the sale of a capital asset equal to the difference, if any, between the proceeds realized from the sale (or other disposition) and the amount paid as the exercise price of the Option. Alternatively, if the incentive stock option holding period requirements are not satisfied, on the subsequent sale (or other disposition) by the optionee of the shares of Common Stock received upon the exercise of the Option, the optionee generally will recognize income taxable as compensation (and the Company will recognize a compensation deduction) in an amount equal to the lesser of (a) the difference, if any, between the fair market value of the shares on the date of exercise and the amount paid as the exercise price of the Option and (b) the difference, if any, between the proceeds realized from the

28

---

## TABLE OF CONTENTS

sale or other disposition and the amount paid as the exercise price of the Option. Any additional gain realized on such sale or disposition (in addition to the compensation income referred to above) would give rise to income from the sale of a capital asset and taxed accordingly.

## **Federal Income Tax Consequences Relating to Non-Qualified Stock Options**

The non-qualified stock options which may be granted under the 2008 Plan are not intended to qualify as incentive stock options within the meaning of Section 422 of the Code. Set forth below is a discussion of all relevant Federal income tax consequences to participants and to us of non-qualified stock options granted under the 2008 Plan.

An individual to whom a non-qualified stock option is granted pursuant to the 2008 Plan will generally not recognize any compensation income, and we will not realize any compensation deduction, at the time the non-qualified stock option is granted. In the year of exercise, however, the optionee generally will realize income taxable as compensation (and we will realize a compensation deduction) in an amount equal to the difference, if any, between the fair market value of the shares on the date of exercise and the amount paid as the exercise price of the Option.

The tax basis of the shares of Common Stock received by the optionee upon exercise will be equal to the amount paid as the exercise price plus the amount, if any, includable in his gross income as compensation income. The holding period for the shares will commence on the date of exercise.

On the subsequent sale (or other disposition) by the optionee of the shares of Common Stock received upon the exercise of the Option, any gain realized on such sale or disposition would give rise to income from the sale of a capital asset and taxed accordingly.

Section 162(m) of the Internal Revenue Code generally disallows a public corporation's tax deduction for compensation to its Chief Executive Officer or any of its four other most highly compensated officers in excess of \$1,000,000 within a year. Compensation that qualifies as performance-based compensation is excluded from the \$1,000,000 deductibility cap, and therefore remains fully deductible by the corporation that pays it. The 2008 Plan has a limit of 600,000 Options that may be granted to an individual in any calendar year. Stock options granted to our Chief Executive Officer and next four highest compensated officers having an exercise price at least equal to fair market value will be deemed performance based as provided in Section 162(m) of the Internal Revenue Code and not subject to the \$1,000,000 deductibility cap. With respect to a stock options granted to our Chief Executive Officer and next four highest compensated officers having an exercise price less than the fair market value of the Common Stock at the date of grant, the compensation expense resulting from the exercise of any such stock options will not qualify as a performance based compensation under the requirements of Section 162(m) of the Internal Revenue Code and will be subject to the \$1,000,000 deductibility cap.

On March 25, 2008, the closing price of our Common Stock on the Nasdaq Capital Market was \$9.02 per share.

## Amendments and Discontinuance of the 2008 Plan

The 2008 Plan can be amended, suspended or terminated at any time by action of our Board of Directors, except that no amendment to the 2008 Plan can be made without prior shareholder approval where such amendment would result in (i) any material increase in the total number of shares of Common Stock subject to the 2008 Plan, (ii) any change in the class of eligible participants for Options under the 2008 Plan, (iii) any material increase in the benefits accruing to participants under the 2008 Plan, or (iv) shareholder approval being required for continued compliance with Rule 16b-3 promulgated under the Securities Exchange Act of 1934, as amended. In addition, the Board may amend the Plan to comply with Section 409A.

29

---

### TABLE OF CONTENTS

## New Plan Benefits

The following table sets forth the benefits to be received under the 2008 Stock Option Plan, assuming ratification by shareholders by the persons or groups set forth below:

## NEW PLAN BENEFITS

### 2008 Stock Option Plan

Name and Position	Dollar Value	Number of Shares Underlying Options
Andrew D. Reddick, President and Chief Executive Officer	*	*
Ron J. Spivey, Senior Vice President and Chief Scientific Officer	*	*
Robert B. Jones, Senior Vice President and Chief Operating Officer	*	*
Peter A. Clemens, Senior Vice President and Chief Financial Officer and Secretary	*	*

Robert A. Seiser, Vice President, Corporate Controller and Treasurer	*	*
James F. Emigh, Vice President of Marketing and Administration	*	*
Executive Group	*	*
Non-Executive Director Group	*	900,000 <sup>(1)</sup>
Non-Executive Officer Employee Group	*	*

\* Not Yet Determinable

(1) Assumes annual option awards to 6 Non-Employee Directors to purchase 15,000 shares each, in each year from 2009 through 2018.

## Vote Required

The majority of the Votes Cast at the Meeting is required for the ratification of the 2008 Plan.

## Recommendation of the Board of Directors

The Board of Directors recommends a vote **FOR** the ratification of the 2008 Plan.

30

### TABLE OF CONTENTS

## PROPOSAL 3

# RATIFICATION OF AMENDMENT TO THE COMPANY'S 2005 RESTRICTED STOCK UNIT AWARD PLAN

Our 2005 Restricted Stock Unit Award Plan (the "RSU Plan") was adopted by our Board of Directors on December 22, 2005. The RSU Plan was amended by the Board of Directors on October 26, 2006, to allow for transfer of Restricted Stock Units ("RSUs") granted under the RSU Plan under limited circumstances, subject to Board approval. The RSU Plan, as amended, was ratified by our shareholders at our 2006 Annual Meeting of Shareholders held on December 14, 2006. The RSU Plan was further amended by the Board of Directors on March 14, 2008 (the "March 2008 RSU Plan Amendment") to increase the number of shares available for issuance under the RSU Plan from 3,000,000 (after giving effect to a 1 for 10 reverse split effected December 5, 2007) to 3,500,000, subject to ratification by shareholders. In this Proposal 3 we seek such shareholder ratification.

A RSU represents the right to receive (upon payment of \$0.01 par value per share) a share of our Common Stock at a designated time or upon designated event. If the March 2008 RSU Plan Amendment is not ratified, the number of share subject to the RSU Plan will not be increased. A copy of the RSU Plan, as amended, is set forth in **Appendix B** to this Proxy Statement.

**Currently Outstanding RSUs.** After giving effect to the March 2008 RSU Amendment, the maximum aggregate number of shares which may be subject to RSUs granted under the RSU Plan was increased from 3,000,000 to 3,500,000 shares of authorized, but unissued, or reacquired Common Stock. (See "Adjustments upon Changes in Capitalization or Merger" below.) As of the date of this Proxy Statement, RSU underlying 3,000,000 shares of Common Stock have been granted under the RSU Plan, leaving a balance of 500,000 shares available for award under the RSU Plan. If an RSU should expire or become forfeited for any reason without the underlying shares of Common



Stock subject to such RSU having been distributed, the underlying shares shall, unless the RSU Plan shall have been terminated, become available for further grant under the RSU Plan. Unless terminated earlier by the Board of Directors, the RSU Plan terminates when all matters relating to RSUs and the administration of the RSU Plan have been completed and all shares of Common Stock underlying outstanding RSUs have been distributed in accordance with the RSU Plan. The RSU Plan allows for amendment by the Board of Directors.

**Purpose.** The RSU Plan is intended to assist us in securing and retaining key employees and directors by allowing them to participate in our ownership and growth through the RSUs. The granting of RSUs serves as partial consideration for and gives key employees, directors and consultants an additional inducement to, remain in the service and will provide them with an increased incentive to work for our success.

The following discussion of the principal features and effects of the RSU Plan, is qualified in its entirety by reference to the text of the RSU Plan, set forth in **Appendix B** attached hereto.

## Administration

The RSU Plan is administered by our Board of Directors, or at the election of the Board, a Committee comprised of not less than two members of the Board, each of whom must be Non-Employee Directors as that term is defined in Rule 16b-3(b)(3)(i) of the Exchange Act (the Committee). At present, the RSU Plan is administered by the Board of Directors.

**Powers of the Board/Committee.** The Board/Committee has the authority, subject to the provisions of the RSU Plan, to establish, adopt and revise such rules, regulations and forms and agreements and to interpret the RSU Plan and make all determinations relating to the RSU Plan as it may deem necessary or advisable. The Board/Committee also has the authority, subject to the provisions of the RSU Plan, to delegate ministerial, day-to-day administrative details and non-discretionary duties and functions to our officers and employees. In the administration of the RSU Plan with respect to Non-Employee Directors, the Board has all of the authority and discretion otherwise granted to the Committee with respect to the administration of the RSU Plan.

All decisions, determinations and interpretations of the Board/Committee are binding and conclusive on participants in the RSU Plan and on their legal representatives and beneficiaries.

31

---

### TABLE OF CONTENTS

**Director Participation in the RSU Plan.** Non-Employee Directors are eligible to receive RSU grants under the RSU Plan.

## RSU Plan Eligibility

RSUs may be granted to any of our Non-Employee Directors, any of our employees or any employees of our subsidiary corporations, including officers (collectively, Eligible Participants). As of the date of this Proxy Statement all of our 14 full-time employees and three Non-Employee Directors were eligible (Participants) in the RSU Plan. Any Eligible Participant who has been granted an RSU may be granted additional RSUs.

The RSU Plan does not confer any rights upon any Participant with respect to continuation of employment or service as an employee or as a Non-Employee Director.

## Terms

**RSU Award Agreement.** Each RSU granted under the RSU Plan is evidenced by a written award agreement ( RSU Award Agreement ), which contains the terms and conditions of the specific RSU granted.

**Vesting of RSUs.** RSUs generally vest as set forth in the RSU Award Agreement. As of March 31, 2008 we had granted RSUs providing for our issuance of up to an aggregate of 3,000,000 shares of our common stock (including 50,000 RSUs to be granted to Mr. Jones on April 7, 2008). 2,750,000 of such RSU Awards vested one-third (1/3) on grant, and the balance vest in equal monthly increments on the first day of each month beginning January 1, 2006 and ending December 1, 2007. An additional 200,000 RSU Awards vested 77,778 shares on grant and the balance vested in equal monthly increments on the first day of March 1, 2006 and ending December 1, 2007. The 50,000 RSUs granted to Mr. Jones vest at the rate of 2,500 on the last day of each calendar month commencing May 31, 2008.

In addition, unless expressly provided otherwise in the RSU Award Agreement, each RSU immediately vests and is nonforfeitable to the Participant upon the occurrence of any of the following events:

(1) a Participant's service as an employee is terminated by us without Cause (as defined) or due to the Participant's death or disability (as defined), or in the case of a Non-Employee Director, upon the Participant's death or Disability or if the Participant is not renominated as a director (other than for Cause or refusal to stand for re-election) or is not elected by our stockholders, if nominated; or

(2) a Change in Control (as defined in the RSU Plan).

Accelerated vesting does not directly translate into accelerated distribution of shares, subject to an RSU Award. For instance if we terminates an employee's employment without cause, such employee's RSUs will immediately vest (unless otherwise provided in the RSU Award Agreement) but, absent a Change in Control he will not commence to receive the shares underlying his RSU award until 2011.

**Distribution of Shares Underlying RSUs.** Absent a Change of Control, one-fourth of the shares of common stock underlying an RSU will be distributed under vested RSUs (after payment of \$0.01 par value per share) on January 1st of each of 2011, 2012, 2013 and 2014. If a Change of Control occurs (whether prior to or after 2011), all vested shares of Common Stock underlying an RSU (after payment of \$0.01 per share par value) will be distributed by us to the holder of the RSU at or about the time of the Change in Control. No dividends accrue on shares of Common Stock underlying RSUs prior to distribution. Participants need not be our employees or directors on a distribution date. A Change in Control for distribution purposes is generally the same as a Change in Control for vesting purposes, except that in order to have a Change in Control for distribution purposes, a change in control qualifying under Section 409A of the Code must occur.

**Non-Transferability of RSUs.** RSUs may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner by the Participant other than by will or by the laws of descent or distribution and to (i) the spouse, children or grandchildren of the awardee (the Immediate Family Members ), (ii) a trust or trusts for the exclusive benefit of such Immediate Family Members, or (iii) a partnership in which such Immediate Family Members are the only partners, provided that (x) there may be no consideration for any such transfer, (y) subsequent transfers of transferred RSUs shall be prohibited except those made by will or by

the laws of descent or distribution, and (z) such transfer is approved in advance by the Committee (or Board in absence of a Committee). A married Participant may generally designate only a spouse as a beneficiary unless spousal consent is obtained.

**Termination of Status as an Employee or Non-Employee Director.** See Vesting of RSUs above for a discussion of vesting upon termination of employment or service as a Non-Employee Director.

**Dividend and Voting Rights.** Unless otherwise provided in an RSU Award Agreement, Participants have no dividend rights and no voting rights with respect to the shares underlying RSUs until the RSUs settle in shares of Common Stock.

## Amendment and Termination of the RSU Plan

The Board, without shareholder approval, may amend or terminate the RSU Plan from time to time in such respects as the Board may deem advisable; provided that, the Board may seek shareholder ratification if it deems such ratification advisable.

## Adjustments upon Changes in Capitalization or Merger

Upon or in contemplation of any reclassification, recapitalization, stock split (including a stock split in the form of a stock dividend) or reverse stock split; any merger, combination, consolidation or other reorganization; any split-up; spin-off, or similar extraordinary dividend distribution with respect to the Common Stock (whether in the form of securities or property); any exchange of our stock or other securities, or any similar, unusual or extraordinary corporate transaction with respect to the Common Stock; or a sale of substantially all of our assets as an entirety; then the Board shall proportionately adjust any or all of (a) the number and type of shares of Common Stock (or other securities or property) that thereafter may be made the subject of RSUs, (b) the number, amount and type of shares of Common Stock (or other securities or property) payable with respect to RSUs, and (c) the number and type of RSUs (both credited and vested) under the RSU Plan.

## Tax Status of the RSU Plan

The following is a summary of the effect of Federal income tax consequences to the holders of RSUs and to us with respect to the grant of RSUs and the purchase and sale of shares under the RSU Plan. The following summary does not purport to be complete, and reference is made to the applicable provisions of the Code. The summary does not address other taxes that may affect recipients of RSUs such as state and local income taxes, Federal and state estate, inheritance and gift taxes and foreign taxes.

**Tax Treatment of RSUs.** A holder will not recognize any taxable income at the time an RSU is granted. Upon distribution of shares of Common Stock underlying an RSU ( Shares ), a holder, will recognize ordinary income for federal tax purposes equal to the difference, if any, between the then fair market value of the Shares and the \$0.01 par value of the Common Stock, which the holder must pay for each Share. Upon a resale of the Shares acquired pursuant to a distribution under an RSU, any difference between the sale price and the holder's tax basis in the Shares (as described below) will be treated as capital gain or loss, and will qualify for long-term capital gain or loss treatment if the shares have been held for more than 12 months. Upon distribution of Shares underlying RSUs, a holder must pay state and federal withholding taxes on the difference between fair market value and the \$0.01 par value per share and must also pay the Medicare portion of the FICA tax on the holder's total compensation and the Social Security portion of FICA taxes on such income to the extent that such holder's total compensation does not exceed the FICA wage base.

The Company receives no tax deduction on the grant of an RSU, but is entitled to a tax deduction when the RSU holder recognizes taxable income on the settlement of the RSU, in the same amount as the income recognized by the holder of the RSU.

**Section 162(m) Disallowance.** Under Section 162(m) of the Code, we may not be able to deduct remuneration paid to certain executives (the CEO and the four next most highly compensated executives) in excess of \$1.0 million dollars in a single tax year. To the extent the value of the Shares distributed to such person in a tax year in settlement of the RSUs together with other consideration paid to such person exceed \$1.0 million, we may not be able to deduct such amounts.

33

---

## TABLE OF CONTENTS

**Excess Parachute Payments.** Under Section 280G and 4999 of the Code, compensatory payments to employees or other individuals who perform services for a corporation and who are officers, highly-compensated individuals or significant stockholders of the corporation may be treated as excess parachute payments, if the payments are contingent on a change in control of the corporation and exceed threshold amounts specified in the Code. Payments are not considered parachute payments if the taxpayer can show by clear and convincing evidence that they constitute reasonable compensation for personal services to be performed after the change in control or that they otherwise are not contingent on the change in control. The value of any accelerated vesting of an RSU is considered a compensatory payment for this purpose. The Treasury regulations under Section 280G provide that, with respect to the acceleration of vesting of shares, the amount treated as contingent on a change in control of the Company is the sum of (a) the increase in the present value resulting from the acceleration of vesting (the Time Value Component ) plus (b) an amount that reflects the elimination of the obligation to perform services in order to continue vesting (the Forfeiture Risk Component ). With respect to each unvested share or RSU, the Time Value Component equals the excess of (a) the value of the share or RSU on the accelerated vesting date divided by (b) the discounted present value of the share or RSU on its original vesting date (assuming that the fair market value of the underlying stock does not change). The present value generally is discounted based on an interest rate equal to 120% of the applicable federal rate (as defined in the Code) in effect on the date of the change in control. The Treasury regulations provide that the value of the Forfeiture Risk Component is 1% of the value of the payment for each full calendar month during which the RSU holder no longer needs to perform services in order to vest in the shares underlying the RSU. Excess parachute payments are not deductible by us and the recipient must pay a nondeductible excise tax equal to 20% of the excess parachute payments (in addition to regular income taxes on such payments). Further, we may have a withholding and reporting obligation, depending on the type of payment.

**Section 409A.** The RSUs are subject to Section 409A of the Code. RSUs granted under the RSU Plan are intended to comply with the provisions of that Section with respect to deferred compensation. If the RSU Plan did not comply with the provisions of 409A, among other things, compensation under the RSU Plan would be subject to a 20% excise tax to the RSU holder.

The following table sets forth the allocation number of Restricted Stock Units issued as of the date of this Proxy Statement All of the RSUs were issued from shares available for awards prior to the March 2008 RSU Plan Amendment. We have not determined how the additional RSU awards available for issuance as a result of the March 2008 RSU Plan Amendment will be allocated. Of the 3,500,000 shares available for RSUs under the Plan, RSUs for 3,000,000 shares have been awarded as of the date of this Proxy Statement.

## **NEW PLAN BENEFITS**

## 2005 Restricted Stock Unit Award Plan<sup>(1)(2)(3)</sup>

Name and Position	Dollar Value	Number of Units
Andrew D. Reddick, President and Chief Executive Officer	\$2,734,875	825,000
Ron J. Spivey, Senior Vice President and Chief Scientific Officer	\$2,187,900	660,000
Robert B. Jones, Senior Vice President and Chief Operating Officer	\$450,500	50,000
Peter A. Clemens, Senior Vice President and Chief Financial Officer and Secretary	\$1,458,600	440,000
Robert A. Seiser, Vice President, Corporate Controller and Treasurer	\$546,975	165,000
James F. Emigh, Vice President of Marketing and Administration	\$455,812	137,500
Executive Group	\$7,834,663	2,277,500
Non-Executive Director Group	\$698,000	200,000
Non-Executive Officer Employee Group	\$1,732,088	522,500

RSUs, awarded to Messrs. Reddick, Spivey, Clemens, Seiser and Emigh on December 22, 2005, which are now (1) fully vested, had vested one-third (1/3) upon grant and the balance in equal monthly increments on the first day of each month beginning January 1, 2006 and ending December 1, 2007. Based on the

34

### TABLE OF CONTENTS

average of the closing bid and asked prices of our Common Stock on December 22, 2005, the date of award of RSUs to our executive officers and employees, of \$3.325 less the exercise price of \$0.01.

RSUs granted to non-executive directors, which are now fully vested, had vested as follows: 38.89% units vest upon issuance and 2.7778% of such units vest on the first day of each month beginning March 1, 2006 and ending (2) December 1, 2007. Based on the closing price of our Common Stock on February 10, 2006, the last trading price prior to the award the RSUs to 2 directors, of \$3.50 less the exercise price of \$0.01.

50,000 RSUs will be granted to Mr. Jones on April 7, 2008. Such RSUs vest at the rate of 2,500 restricted stock (3) units on the last day of each calendar month commencing May 31, 2008. Based on the closing price of our Common Stock on March 25, 2008 of \$9.02 per share less the exercise price of \$0.01.

### **Vote Required**

The majority of Votes Cast at the Meeting is required for the ratification of the amendment to the RSU Plan.

### **Recommendation of the Board of Directors**

The Board of Directors recommends a vote **FOR** the ratification of the amendment to the RSU Plan.

35

### TABLE OF CONTENTS

## **PROPOSAL 4**

# RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

There will also be submitted for consideration and voting at the Meeting, the ratification of the appointment by our Audit Committee and our Board of Directors of BDO Seidman, LLP as our independent registered public accounting firm for the purpose of auditing and reporting upon our financial statements for the fiscal year ending December 31, 2008. Our Audit Committee and Board of Directors selected and approved the accounting firm of BDO Seidman, LLP as our independent registered public accounting firm to audit and report upon our financial statements for each of the fiscal years ended December 31, 2007 and 2006. BDO Seidman, LLP has no direct or indirect financial interest in the Company.

Representatives of BDO Seidman, LLP are expected to be present at the Meeting, and they will be afforded an opportunity to make a statement at the Meeting if they desire to do so. It is also expected that such representatives will be available at the Meeting to respond to appropriate questions by shareholders.

Our registered independent public accounting firm is BDO Seidman, LLP. The fees billed by this firm in 2007 and 2006 were as follows:

	2006	2007
Audit Fees	\$ 87,600	\$ 85,825
Audit-Related Fees		
Total Audit and Audit-Related Fees	87,600	85,825
Tax Fees	25,600	30,168
All Other Fees	1,333	
Total for BDO Seidman, LLP	\$ 114,533	\$ 115,993

Audit Fees include professional services rendered in connection with the annual audits of our financial statements, and the review of the financial statements included in our Forms 10-Q for the related annual periods. Additionally, Audit Fees include other services that only an independent registered public accounting firm can reasonably provide, such as services associated with SEC registration statements or other documents filed with the SEC or used in connection with financing activities.

Audit-Related Fees include the audits of employee benefit plans and accounting consultations related to accounting, financial reporting or disclosure matters not classified as Audit Fees. Tax Fees include tax compliance, tax advice and tax planning services. These services related to the preparation of various state and federal tax returns and review of Section 409 compliance.

## Audit Committee's Pre-Approval Policies and Procedures

Consistent with policies of the SEC regarding auditor independence and the Audit Committee Charter, the Audit Committee has the responsibility for appointing, setting compensation and overseeing the work of the registered independent public accounting firm (the Firm). The Audit Committee's policy is to pre-approve all audit and permissible non-audit services provided by the Firm. Pre-approval is detailed as to the particular service or category of services and is generally subject to a specific budget. The Audit Committee may also pre-approve particular services on a case-by-case basis. In assessing requests for services by the Firm, the Audit Committee considers whether such services are consistent with the Firm's independence, whether the Firm is likely to provide the most effective and efficient service based upon their familiarity with us, and whether the service could enhance our ability to manage or

control risk or improve audit quality.

All of the audit-related, tax and other services provided by BDO Seidman in 2007 and 2006 and related fees (as described in the captions above) were approved in advance by the Audit Committee.

36

---

TABLE OF CONTENTS

## **AUDIT COMMITTEE REPORT**

Our Audit Committee of the Board of Directors (the Audit Committee ) was composed of three directors (William A. Sumner, Chairman, Immanuel Thangaraj and Bruce F. Wesson) during 2007. On January 24, 2008, the Audit Committee was reconstituted and effective at such date, the members are George K. Ross, Chairman, William A. Sumner and William G. Skelly. The Audit Committee operates under a written charter adopted by the Board of Directors. The charter is available on our website at [www.acurapharm.com](http://www.acurapharm.com) under the link Ethics/Audit Charter. Management is responsible for our internal control and financial reporting process. Our independent public accountants are responsible for performing an independent audit of our consolidated financial statements in accordance with the auditing standards of the PCAOB and to issue a report thereon. The Audit Committee's responsibility is to monitor and oversee these processes.

In this context, the Audit Committee has met and held discussions with Management and our independent public accountants. Management represented to the Audit Committee that our consolidated financial statements were prepared in accordance with generally accepted accounting principles, and the Audit Committee has reviewed and discussed the consolidated financial statements with Management and our independent public accountants. The Audit Committee discussed with the independent public accountants matters required to be discussed by Statement of Auditing Standards Numbers 90 and 61 (communication with Audit Committees). Our independent public accountants also provided to the Audit Committee the written disclosures required by Independence Standard No. 1 (independent discussions with Audit Committee), and the Audit Committee discussed with the independent public accountants that firm's independence. The Audit Committee has also considered whether the independent auditors' provision of non-audit services to us is compatible with the auditor's independence.

Based upon the Audit Committee's discussions with Management and the independent public accountants and the Audit Committee's review of the representation of Management and the report of the independent public accountants, the Audit Committee recommended that the Board of Directors include our audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2007 filed with the Securities and Exchange Commission.

The foregoing has been approved by all members of the Audit Committee.

George K. Ross (Chairman)  
William A. Sumner  
William G. Skelly

## **Recommendation of the Board of Directors**

The Board of Directors recommends a vote **FOR** the ratification of the appointment of BDO Seidman LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2008.

## Vote Required

A majority of the Votes Cast at the Meeting is required to ratify the appointment of BDO Seidman, LLP as our independent registered accounting firm for the fiscal year ending December 31, 2008.

37

### TABLE OF CONTENTS

## SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information regarding the beneficial ownership of the Common Stock, as of February 1, 2008, for individuals or entities in the following categories: (i) each of our Directors and nominees for Directors; (ii) our principal executive officer, our principal financial officer and our next three highest paid executive officers whose total annual compensation for 2007 exceeded \$100,000 (the named executive officers); (iii) all Directors and executive officers as a group; and (iv) each person known by us to be a beneficial owner of more than 5% of the Common Stock. Unless indicated otherwise, each of the shareholders has sole voting and investment power with respect to the shares beneficially owned.

Name of Beneficial Owner	Amount Owned		Percent of Class <sup>(1)</sup>	
GCE Holdings LLC, c/o Galen Partners III, L.P. 680 Washington Boulevard, Stamford, CT 06901	34,564,956	(2)	77.7	%
Vivo Ventures Fund VI, L.P. 575 High St, Suite 201 Palo Alto, CA 9430131	2,450,000	(3)	5.7	%
Andrew D. Reddick	875,000	(4)	2.0	%
Ron J. Spivey	700,000	(5)	1.6	%
William G. Skelly	33,333	(6)	*	
Bruce F. Wesson	(2)(7)		*	
William A. Sumner	24,000	(8)	*	
Peter A. Clemens	105,080	(9)	*	
Richard J. Markham	(2)(10)		*	
Immanuel Thangaraj	(2)(11)		*	
Robert A. Seiser	40,000	(12)	*	
James F. Emigh	44,500	(13)	*	
George K. Ross	5,000	(14)	*	
All Officers and Directors as a Group (11 persons)	1,826,913	(15)	4.1	%

\* Represents less than 1% of the outstanding shares of our Common Stock.

(1) Shows percentage ownership assuming (i) such party converts all of its currently convertible securities or securities convertible within 60 days of February 1, 2008 into our common stock, and (ii) no other Company securityholder converts any of its convertible securities. No shares held by any Director or named executive officer has been pledged as collateral security.



GCE Holdings LLC, a Delaware limited liability company, was the assignee of all of the our preferred stock (prior to its conversion into common stock) and bridge loans entered into in 2005, 2006 and 2007 (prior to their conversion into common stock and warrants) formerly held by each of Galen Partners III, L.P., Galen Partners International III, L.P., Galen Employee Fund III, L.P. (collectively, Galen ), Care Capital Investments II, LP, Care Capital Offshore Investments II, LP (collectively, Care Capital ) and Essex Woodlands Health Ventures Fund V, L.P. ( Essex ). Galen, Care Capital and Essex own approximately 39.8%, 30.6% and 29.6%, respectively, of the membership interests in GCE Holdings LLC. The following natural persons exercise voting, investment and dispositive rights over our securities held of record by GCE Holdings LLC: (i) Galen Partners III, L.P., Galen Partners International III, L.P. and Galen Employee Fund III, L.P.: Bruce F. Wesson, L. John Wilkenson, David W. Jahns, and Zubeen Shroff; (ii) Care Capital Investments II, LP and Care Capital Offshore Investments II, LP: Jan Leschly, Richard Markham, Argeris Karabelas and David Ramsay; and (iii) Essex Woodlands Health Ventures Fund V, L.P.: Immanuel Thangaraj, James L. Currie and Martin P. Sutter. Pursuant to a Voting Agreement among us, GCE Holdings LLC and certain other shareholders, GCE Holdings LLC has the right to designate three of the seven members of our Board of Directors. The Board designees of GCE Holdings LLC are Immanuel Thangaraj, Richard Markham and Bruce Wesson. Amounts for GCE Holdings, LLC include 1,786,481 shares underlying warrants, exercisable at \$3.40 per share.

38

---

TABLE OF CONTENTS

Includes shares held by an affiliated fund. Includes warrants to purchase 450,000 shares exercisable at \$3.40 per share held by Vivo Ventures Fund VI, L.P. and an affiliated fund. Number of shares give effect to the transfer of warrants to purchase 496,364 and 3,636 shares from Vivo Ventures Fund VI, L.P. and Vivo Ventures VI Affiliates Fund, L.P., respectively, to Warrant Strategies Fund, LLC on November 30, 2007 but are otherwise current as of November 20, 2007.

Includes 875,000 shares subject to currently exercisable stock options. Excludes 825,000 restricted stock unit awards ( RSUs ) granted to Mr. Reddick. Mr. Reddick has no rights as a stockholder, including no dividend or voting rights, with respect to the shares underlying the RSUs until the shares are issued by us pursuant to the terms our 2005 Restricted Stock Unit Plan.

Includes 700,000 shares subject to currently exercisable stock options. Excludes 660,000 RSUs granted to Dr. Spivey. Dr. Spivey has no rights as a stockholder, including no dividend or voting rights, with respect to the shares underlying the RSUs until the shares are issued by us pursuant to the terms of our 2005 Restricted Stock Unit Plan.

Includes 29,000 shares subject to currently exercisable stock options. Excludes 100,000 RSUs granted to Mr. Skelly. Mr. Skelly has no rights as a stockholder, including no dividend or voting rights, with respect to the shares underlying the RSUs until the shares are issued by us pursuant to the terms of the our 2005 Restricted Stock Unit Plan.

Mr. Wesson s holdings do not include securities held by GCE or (i) 183,886 shares; (ii) 470,184 shares underlying warrants; or (iii) 15,000 shares underlying options, held by Galen.

Includes 5,000 shares subject to currently exercisable stock options. Excludes 100,000 RSUs granted to Mr. Sumner. Mr. Sumner has no rights as a stockholder, including no dividend or voting rights, with respect to the shares underlying the RSUs until the shares are issued by us pursuant to the terms of our 2005 Restricted Stock Unit Plan.

Includes 100,000 shares subject to stock options exercisable within 60 days of March 1, 2008. Excludes 440,000 RSUs granted to Mr. Clemens. Mr. Clemens has no rights as a stockholder, including no dividend or voting rights, with respect to the shares underlying the RSUs until the shares are issued by us pursuant to the terms our 2005 Restricted Stock Unit Plan. Includes 4,780 shares held by minor children.

Mr. Markham s holdings do not include amounts held by GCE or (i) 111,689 shares; or (ii) 15,000 shares underlying warrants, held by Care Capital.

Mr. Thangaraj s holdings do not include GCE s holdings or (i) 136,178 shares; (ii) 34,500 shares underlying warrants; or (iii) 10,000 shares underlying options, held by Essex.

(12)

Includes 40,000 shares subject to stock options exercisable within sixty days of March 1, 2008. Excludes 165,000 RSUs granted to Mr. Seiser. Mr. Seiser has no rights as a stockholder, including no dividend or voting rights, with respect to the shares underlying the RSUs until the shares are issued by us pursuant to the terms of our 2005 Restricted Stock Unit Plan.

(13) Includes 40,000 shares subject to stock options exercisable within 60 days of March 1, 2008. Excludes 137,500 RSUs granted to Mr. Emigh. Mr. Emigh has no rights as a stockholder, including no dividend or voting rights, with respect to the shares underlying the RSUs until the shares are issued by us pursuant to the terms our 2005 Restricted Stock Unit Plan.

(14) Includes 5,000 shares which Mr. Ross has the right to acquire within 60 days of February 1, 2008 through exercise of outstanding stock options.

(15) Includes 36,103 shares which Directors and executive officers have the right to acquire within 60 days of February 1, 2008 through exercise of outstanding stock options.

39

---

TABLE OF CONTENTS

## GENERAL

We do not know of any matters other than those stated in this Proxy Statement that are to be presented for action at the Meeting. If any other matters should properly come before the Meeting, proxies will be voted on those other matters in accordance with the judgment of the persons voting the proxies. Discretionary authority to vote on such matters is conferred by such proxies upon the persons voting them.

We will bear the cost of preparing, printing, assembling and mailing all proxy materials that may be sent to shareholders in connection with this solicitation. Arrangements will also be made with brokerage houses, other custodians, nominees and fiduciaries, to forward soliciting material to the beneficial owners of our Common Stock held by such persons. We will reimburse such persons for reasonable out-of-pocket expenses incurred by them. In addition to the solicitation of proxies by use of the mails, our officers and regular employees of the Company may solicit proxies without additional compensation, by telephone or facsimile. We do not expect to pay any compensation for the solicitation of proxies.

A copy of our Annual Report to Shareholders on Form 10-K for the fiscal year ended December 31, 2007, as filed with the SEC, accompanies this Proxy Statement. Upon written request, we will provide each shareholder being solicited by this Proxy Statement with a free copy of any exhibits and schedules thereto. All such requests should be directed to Acura Pharmaceuticals, Inc., 616 N. North Court, Suite 120, Palatine, Illinois 60067, Attention: Mr. Peter A. Clemens, Senior Vice President and Chief Financial Officer, telephone (847) 705-7709.

All properly executed proxies delivered pursuant to this solicitation and not revoked, will be voted at the Meeting and will be voted in accordance with the specifications made thereon. In voting by proxy in regard to the election of directors, shareholders may vote in favor of each nominee or withhold votes as to all nominees or votes as to a specific nominee. With respect to (i) voting on the ratification of the adoption of our 2008 Stock Option Plan, (ii) voting on the ratification of the amendment to our 2005 Restricted Stock Unit Award Plan; and (iii) voting on the ratification of our independent public accountants, shareholders may vote in favor of, may vote against or may abstain from voting on each of such proposals. Shareholders should specify their choices on the enclosed Proxy. If no specific instructions are given with respect to the matters to be acted upon, the shares represented by the Proxy will be voted **FOR** the election of all directors, **FOR** the ratification of the adoption of our 2008 Stock Option Plan, **FOR** the ratification of the amendment to our 2005 Restricted Stock Unit Award Plan and **FOR** the ratification of the appointment of BDO Seidman, LLP as our independent certified public accountants for the fiscal year ending December 31, 2008.

# SHAREHOLDER PROPOSALS FOR 2009 ANNUAL MEETING

Any shareholder proposals intended to be presented at our 2009 Annual Meeting of Shareholders must be received by us on or before December 4, 2008 in order to be considered for inclusion in our proxy statement and proxy relating to such meeting.

Securities and Exchange Commission rules establish a different deadline for submission of stockholder proposals that are not intended to be included in our proxy statement with respect to discretionary voting. The deadline for these proposals for the year 2009 annual meeting is February 17, 2009. If a stockholder gives notice of such a proposal after this deadline, our proxy holders will be allowed to use their discretionary authority to vote against the stockholder proposal when and if the proposal is raised at our 2009 Annual Meeting of Shareholders.

By Order of the Board of Directors

PETER A. CLEMENS,  
Secretary

April 2, 2008

40

---

## TABLE OF CONTENTS

### APPENDIX A

## 2008 STOCK OPTION PLAN

1. **Purposes.** The Plan described herein, as amended and restated, shall be known as the Acura Pharmaceuticals, Inc. 2008 Stock Option Plan (the Plan). The purposes of the Plan are to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive to Employees, Directors and Consultants of the Company or its Subsidiaries (as defined in Section 2 below) to whom Option's may be granted under this Plan, and to promote the success of the Company's business.

Options granted hereunder may be either incentive stock options, as defined in Section 422 of the Internal Revenue Code of 1986, as amended, or Non-ISO's, at the discretion of the Board and as reflected in the terms of the written option agreement.

The Plan is not intended as an agreement or promise of employment. Neither the Plan, nor any Option granted pursuant to the Plan, shall confer on any person any right to continue in the employ of the Company. The right of the Company to terminate an Employee is not limited by the Plan, nor by any Option granted pursuant to the Plan, unless such right is specifically described by the terms of any such Option.

2. **Definitions.** As used herein, the following definitions shall apply:

(a) *409A Award Agreement* has the meaning set forth in Section 24.1.

- (b) *Board* shall mean the Committee, if one has been appointed, or the Board of Directors of the Company, if no Committee is appointed.
- (c) *Code* shall mean the Internal Revenue Code of 1986, as amended.
- (d) *Committee* shall mean the Committee appointed under Section 4(a) hereof.
- (e) *Common Stock* shall mean the Common Stock, \$.01 par value, of the Company.
- (f) *Company* shall mean Acura Pharmaceuticals, Inc., a New York corporation.
- (g) *Continuous Service or Continuous Status as an Employee* shall mean the absence of any interruption or termination of service as an Employee. Continuous Status as an Employee shall not be considered interrupted in the case of sick leave, military leave, or any other leave of absence approved by the Board.
- (h) *Director* shall mean any person serving on the Board of Directors.
- (i) *Employee* shall mean any person, including officers, employed by the Company or any Parent or Subsidiary of the Company. The payment of a Director's fee by the Company shall not be sufficient to constitute employment by the Company.
- (j) *Exchange Act* shall mean the Securities Exchange Act of 1934, as amended.
- (k) *Fair Market Value* shall mean (i) the closing price for a share of the Common Stock on the exchange or quotation system which reports or quotes the closing prices for a share of the Common Stock, as accurately reported for any date (or, if no shares of Common Stock are traded on such date, for the immediately preceding date on which shares of Common Stock were traded) in *The Wall Street Journal* (or if *The Wall Street Journal* no longer reports such price, in a newspaper or trade journal selected by the Committee) or (ii) if no such price quotation is available, the price which the Committee acting in good faith determines through any reasonable valuation method that a share of Common Stock might change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of the relevant facts (provided that such valuation method complies with Treas. Regulation 1.409A-1(b)(5)(iv), or any successor regulation).
- (l) *Incentive Stock Option* shall mean an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code.

A-1

---

TABLE OF CONTENTS

- (m) *Non-ISO* shall mean an Option to purchase stock which is not intended by the Committee to satisfy the requirements of Section 422 of the Code. A Non-ISO shall also mean a non-qualified stock option.
- (n) *Option* shall mean a stock option granted pursuant to the Plan.
- (o) *Optioned Stock* shall mean the Common Stock subject to an Option.
- (p) *Optionee* shall mean an Employee, Director or Consultant who receives an Option.
- (q) *Parent* shall mean a parent corporation, whether now or hereafter existing, as defined in Section 424(e) of the Code.

(r) *Plan* shall mean this Acura Pharmaceuticals, Inc. 2008 Stock Option Plan, as amended from time to time.

(s) *Rule 16b-3* shall mean Rule 16b-3 of the General Rules and Regulations under the Exchange Act.

(t) *Section 409A Award* has the meaning set forth in Section 24.1.

(u) *Share* shall mean a share of the Common Stock, as adjusted in accordance with Section 11 of the Plan.

(v) *Subsidiary* shall mean a subsidiary corporation, whether now or hereafter existing, as defined in Section 424(f) of the Code.

(w) *Ten Percent Shareholder* shall mean a person who owns (after taking into account the attribution rules of Section 424(d) of the Code) more than ten percent (10%) of the total combined voting power of all classes of stock of the Company, or a Subsidiary.

### 3. *Stock Authorized.*

Subject to the provisions of Section 11 of the Plan, the maximum aggregate number of shares which may be Optioned and sold under the Plan is six million (6,000,000) shares of authorized, but unissued, or reacquired Common Stock. The maximum number of shares which may be subject to Options granted to any one person in any calendar year at fair market value on the date of grant shall not exceed 600,000 shares (subject to adjustment under Section 11 hereof consistent with Section 162(m) of the Code). If the shares that would be issued or transferred pursuant to any Options are not issued or transferred and ceased to be issuable or transferable for any reason, the number of shares subject to such Option will no longer be charged against a limitation provided for herein and may again be subject to Options.

Notwithstanding the preceding sentence, with respect to any Option granted to any individual who is a covered employee within the meaning of Section 162(m) of the Code that is cancelled, the number of shares subject to such Option shall continue to count against the maximum number of shares which may be the subject of Options granted to such individual. For purposes of the preceding sentence if, after grant, the exercise price of an Option is reduced, such reduction shall be treated as a cancellation of such Option and the grant of a new Option, and both the cancellation of the Option and the new Option shall reduce the maximum number of shares for which Options may be granted to the holder of such Option in a calendar year.

If an Option should expire or become unexercisable for any reason without having been exercised in full, the unpurchased Shares which were subject thereto shall, unless the Plan shall have been terminated, become available for further grant under the Plan.

### 4. *Administration.*

(a) *Procedure.* The Company's Board of Directors may appoint a Committee to administer the Plan which shall be constituted so as to permit the Plan to continue to comply with Rule 16b-3, as currently in effect or as hereafter modified or amended. The Committee appointed by the Board of Directors shall consist of not less than two members of the Board of Directors, to administer the Plan on behalf of the Board of Directors, subject to such terms and conditions as the Board of Directors may prescribe. Once appointed, the Committee shall continue to serve until otherwise directed by the Board of Directors. From time to time, the Board of Directors may increase the size of the Committee and appoint additional members thereof, remove

members (with or without cause), and appoint new members in substitution therefor, fill vacancies however caused, or remove all members of the Committee and thereafter directly administer the Plan; provided, however, that at no time shall a Committee of less than two members administer the Plan. Subject to the provisions of the Plan, the Committee shall be authorized to interpret the Plan, to establish, amend and rescind any rules and regulations relating to the Plan and to make all other determinations necessary or advisable for the administration of the Plan. Notwithstanding anything to the contrary contained herein, no member of the Committee shall serve as such under this Plan unless such person is a Non-Employee Director within the meaning of Rule 16b-3(b)(3)(i) of the Exchange Act. A majority vote of the members of the Committee shall be required for all of its actions.

A majority of the entire Committee shall constitute a quorum, and the action of the majority of the Committee members present at any meeting at which a quorum is present shall be the action of the Committee. All decisions, determinations, and interpretations of the Committee shall be final and conclusive on all persons affected thereby and shall, as to Incentive Stock Options, be consistent with Section 422 of the Code. The Committee shall have all of the powers and duties set forth herein, as well as such additional powers and duties as the Board of Directors may delegate to it; provided, however, that the Board of Directors expressly retains the right in its sole discretion (i) to elect and to replace the members of the Committee, and (ii) to terminate or amend this Plan in any manner consistent with applicable law.

(b) *Powers of the Committee.* Subject to the provisions of the Plan, the Committee shall have the authority, in its discretion: (i) to grant Incentive Stock Options, in accordance with Section 422 of the Code, or to grant Non-ISO's; (ii) to determine the Fair Market Value of the Common Stock; (iii) to determine the exercise price per share of Options to be granted which exercise price shall be determined in accordance with Section 8 of the Plan; (iv) to determine the persons to whom (including, without limitation, members of the Committee) and the time or times at which, Options shall be granted and the number of Shares to be represented by each Option; (v) to interpret the Plan; (vi) to prescribe, amend and rescind rules and regulations relating to the Plan; (vii) to determine the terms and provisions of each Option granted (which need not be identical) and, with the consent of the holder thereof, modify or amend each Option; (viii) to accelerate or defer (with the consent of the Optionee) the exercise date of any Option; (ix) to authorize any person to execute on behalf of the Company any instrument required to effectuate the grant of an Option previously granted by the Board; and (x) to make all other determinations deemed necessary or advisable for the administration of the Plan.

(c) Subject to the provisions of this Plan and compliance with Rule 16b-3 of the Exchange Act, the Committee may grant options under this Plan to members of the Company's Board of Directors, including members of the Committee, and in such regard may determine:

(i) the time at which any such Option shall be granted;

(ii) the number of Shares covered by any such Option;

(iii) the time or times at which, or the period during which, any such Option may be exercised or whether it may be exercised in whole or in installments;

(iv) the provisions of the agreement relating to any such Option; and

(v) the Option Price of Shares subject to an Option granted such Board member.

(d) *Effect of the Committee's Decision.* All decisions, determinations and interpretations of the Committee shall be final and binding on all Optionees and any other holders of any Options granted under the Plan.

5. **Eligibility.** Incentive Stock Options may be granted only to Employees. Non-ISO's may be granted to Employees as well as non-employee Directors and Consultants of the Company as determined by the Board or any Committee.

Any person who has been granted an Option may, if he is otherwise eligible, be granted an additional Option or Options.

Each grant of an Option shall be evidenced by an Option Agreement, and each Option Agreement shall (1) specify whether the Option is an Incentive Stock Option or a Non-ISO and (2) incorporate such other

A-3

---

TABLE OF CONTENTS

terms and conditions as the Committee acting in its absolute discretion deems consistent with the terms of this Plan, including, without limitation, a restriction on the number of shares of stock subject to the Option which first become exercisable during any calendar year.

To the extent that the aggregate Fair Market Value of the stock of the Company subject to Incentive Stock Options granted (determined as of the date such an Incentive Stock Option is granted) which first become exercisable in any calendar year exceeds \$100,000, such Options shall be treated as Non-ISO's. This \$100,000 limitation shall be administered in accordance with the rules under Section 422(d) of the Code.

6. ***Effective Date and Term of Plan.*** The effective date of this Plan ( Effective Date ) shall be the date it is adopted by the Board, provided the shareholders of the Company (acting at a duly called meeting of such shareholders or by the written consent of shareholders) approve this Plan within twelve (12) months after such Effective Date. The effectiveness of Options granted under this Plan prior to the date such shareholder approval is obtained shall be contingent on such shareholder approval.

Subject to the provisions of Section 13 hereof, no Option shall be granted under this Plan on or after the earlier of

(1) the tenth anniversary of the Effective Date of this Plan in which event the Plan otherwise thereafter shall continue in effect until all outstanding Options shall have been surrendered or exercised in full or no longer are exercisable, or

(2) the date on which all of the Common Stock reserved for issuance under Section 3 of this Plan has (as a result of the exercise or expiration of Options granted under this Plan) been issued or no longer is available for use under this Plan, in which event the Plan also shall terminate on such date.

7. ***Term of Option.*** An Option shall expire on the date specified in such Option, which date shall not be later than the tenth anniversary of the date on which the Option was granted, except that, if any Employee, at any time an Incentive Stock Option is granted to him or her, owns stock representing more than ten percent (10%) of the total combined voting power of all classes of Common Stock (or, under Section 424(d) of the Code is deemed to own stock representing more than ten percent (10%) of the total combined voting power of all such classes of Common Stock, by reason of the ownership of such classes of stock, directly or indirectly, by or for any brother, sister, spouse, ancestor or lineal descendant of such Employee, or by or for any corporation, partnership, state or trust of which such Employee is a shareholder, partner or beneficiary), the Incentive Stock Option granted him or her shall not be exercisable after the expiration of five (5) years from the date of grant or such earlier expiration as provided in the particular Option agreement.

***8. Exercise Price and Consideration.***

(a) The per Share exercise price for the Shares to be issued pursuant to exercise of an Option shall be such price as is determined by the Board, but shall be subject to the following:

(i) In the case of an Incentive Stock Option

(A) granted to an Employee who, immediately before the grant of such Incentive Stock Option, owns stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the per Share exercise price shall be no less than 110% of the Fair Market Value per Share on the date of grant.

(B) granted to any Employee, the per share exercise price shall be no less than 100% of the Fair Market Value per Share on the date of grant.

(ii) In the case of a Non-ISO, the per share exercise price shall be determined by the Board on the date of grant.

(b) The consideration to be paid for the Shares to be issued upon exercise of an Option, including the method of payment, shall be determined by the Board and may consist entirely of

(i) cash;

(ii) check;

A-4

---

#### TABLE OF CONTENTS

(iii) subject to section 402 of the Sarbanes-Oxley Act of 2002 as amended from time to time and subject to such terms and conditions as the Committee may impose, promissory note, provided such promissory note shall be full recourse as to principal and interest and shall bear interest at the market rate, which market rate shall be equal to the rate of interest available to the Optionee in a third party arms-length loan transaction of similar nature and amount;

(iv) Shares of Common Stock having been held by the Optionee for at least six (6) months prior to being surrendered as consideration for the Shares to be issued upon exercise of an Option and having a Fair Market Value on the date of surrender equal to the aggregate exercise price of the Shares as to which said Option shall be exercised, or any combination of such methods of payment; or

(v) such other consideration and method of payment for the issuance of Shares to the extent permitted under New York law.

The Company shall be permitted to withhold shares to be issued under the Option to pay related income tax withholding requirements. The amount of such tax withholding shall be no greater than the applicable statutory withholding amount.

#### ***9. Exercise of Option.***

(a) *Procedure for Exercise; Rights as a Shareholder.* Any Option granted hereunder shall be exercisable at such times and under such conditions as determined by the Committee, including performance criteria with respect to the Company and/or the Optionee, and as shall be permissible under the terms of the Plan.

An Option may not be exercised for a fraction of a Share.

An Option shall be deemed to be exercised when written notice of such exercise has been given to the Company in accordance with the terms of the Option by the person entitled to exercise the Option and full payment for the Shares with respect to which the Option is exercised has been received by the Company. Full payment may, as authorized by the Board, consist of any consideration and method of payment allowable under Section 8(b) of the Plan. Until the issuance, which in no event will be delayed more than thirty (30) days from the date of the exercise of the Option, (as



evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company) of the stock certificate evidencing such Shares, no right to vote or receive dividends or any other rights as a shareholder shall exist with respect to the Optioned Stock, notwithstanding the exercise of the Option. No adjustment will be made for a dividend or other right for which the record date is prior to the date the stock certificate is issued, except as provided in the Plan.

Exercise of an Option in any manner shall result in a decrease in the number of Shares which thereafter may be available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised.

(b) *Termination of Status as an Employee, or Director or Consultant with Respect to Non-ISO's.* Non-ISO's granted pursuant to the Plan may be exercised notwithstanding the termination of the Optionee's status as an employee, a non-employee Director or a Consultant, except as provided in the Plan or as provided by the terms of the Stock Option Agreement.

(c) *Termination of Service as an Employee with Respect to Incentive Stock Options.* If the Continuous Service of any Employee terminates, he or she may, but only within thirty (30) days (or such other period of time not exceeding three (3) months as is determined by the Committee) after the date he or she ceases to be an Employee of the Company, exercise his or her Incentive Stock Option to the extent that he or she was entitled to exercise it as of the date of such termination. To the extent that he or she was not entitled to exercise the Incentive Stock Option at the date of such termination, or if he or she does not exercise such Option (which he or she was entitled to exercise) within the time specified herein, the Option shall terminate.

(d) *Disability of Optionee.* Notwithstanding the provisions of Section 9(c) above, subject to Section 24 hereof, in the event an Employee is unable to continue his or her Continued Service with the Company as a result of his or her total and permanent disability (within the meaning of Section 22(e)(3) of the Code), he or

A-5

---

## TABLE OF CONTENTS

she may, but only within three (3) months (or such other period of time not exceeding twelve (12) months as is determined by the Committee) from the date of disability, exercise his or her Option to the extent he or she was entitled to exercise it at the date of such disability. To the extent that he or she was not entitled to exercise the Option at the date of disability, or if he or she does not exercise such Option (which he or she was entitled to exercise) within the time specified herein, the Option shall terminate.

(e) *Death of Optionee.* In the event of the death of an Optionee:

(i) during the term of the Option who is at the time of his or her death an Employee of the Company and who shall have been in Continuous Status as an Employee, a Director or Consultant since the date of grant of the Option, the Option may be exercised, subject to Section 24 hereof, at any time within twelve (12) months following the date of death, by the Optionee's estate or by a person who acquired the right to exercise the Option by bequest or inheritance, but only to the extent of the right to exercise that would have accrued had the Optionee continued living one (1) month after the date of death; or

(ii) within thirty (30) days (or such other period of time not exceeding three (3) months as is determined by the Committee) after the termination of Continuous Status as an Employee, a Director or Consultant, subject to Section 24 hereof, the Option may be exercised, at any time within three (3) months following the date of death, by the Optionee's estate or by a person who acquired the right to exercise the Option by bequest or inheritance, but only to the extent of the right to exercise that had accrued at the date of termination; except in the case of a Non-ISO, as

otherwise provided in any option agreement between the Company and the Optionee.

**10. *Transferability of Options.***

(a) Incentive Stock Options may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the life time of the Optionee only by the Optionee.

(b) Non-ISOs may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the Optionee, only by the Optionee; provided that the Board, in its sole discretion, may permit limited transferability, from time to time, on a general or specific basis, and may impose conditions and limitations on any permitted transferability. Following transfer, any such Options shall continue to be subject to the same terms and conditions as were applicable immediately prior to transfer, provided that for purposes of determining the rights of exercise under the Option, the term Optionee shall be deemed to refer to the transferee. The termination of service as an employee, non-employee director or consultant shall continue to be applied with respect to the original Optionee, following which the options shall be exercisable by the transferee only to the extent, and for the periods specified in Section 9 of the Plan and in the Stock Option Agreement.

**11. *Adjustments upon Changes in Capitalization or Merger.*** Subject to any required action by the shareholders of the Company, the number of shares of Common Stock covered by each outstanding Option, and the number of shares of Common Stock which have been authorized for issuance under the Plan but as to which no Options have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Option, as well as the price per share of Common Stock covered by each such outstanding Option, shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split or the payment of a stock dividend with respect to the Common Stock or any other increase or decrease in the number of issued shares of Common Stock effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been effected without receipt of consideration.

Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or exercise price of shares of Common Stock subject to an Option.

A-6

---

**TABLE OF CONTENTS**

In the event of the proposed dissolution or liquidation of the Company, or in the event of a proposed sale of all or substantially all of the assets of the Company, or the merger of the Company with or into another corporation, the Board may, in the exercise of its sole discretion in such instances, accelerate the vesting of all or any portion of Options then outstanding.

**12. *Time for Granting Options.*** The date of grant of an Option shall, for all purposes, be the date on which the Board makes the determination granting such Option. Notice of the determination shall be given to each Employee, non-employee Director and Consultant to whom an Option is so granted within a reasonable time after the date of such grant.

**13. *Amendment and Termination of the Plan.*** (a) The Board may amend or terminate the Plan from time to time in such respects as the Board may deem advisable; provided that, the following revisions or amendments shall require approval of the holders of a majority of the outstanding shares of the Company entitled to vote:

(i) any increase in the number of Shares subject to the Plan, other than in connection with an adjustment under Section 11 of the Plan;

(ii) any change in the class of Employees which are eligible participants for Options under the Plan; or

(iii) if shareholder approval of such amendment is required for continued compliance with Rule 16b-3.

(b) *Shareholder Approval.* Any amendment requiring shareholder approval under Section 13(a) of the Plan shall be solicited as described in Section 17 of the Plan.

(c) *Effect of Amendment or Termination.* Any such amendment or termination of the Plan shall not affect Options already granted and such Options shall remain in full force and effect as if this Plan had not been amended or terminated, unless mutually agreed otherwise between the Optionee and the Board, which agreement must be in writing and signed by the Optionee and the Company.

14. ***Conditions upon Issuance of Shares.*** Shares shall not be issued pursuant to the exercise of an Option unless the exercise of such Option and the issuance and delivery of such Shares pursuant thereto shall comply with all relevant provisions of law, including, without limitation, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, and the requirements of any stock exchange upon which the Shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

As a condition to the exercise of an Option, the Company may require the person exercising such Option to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required by any of the aforementioned relevant provisions of law.

15. ***Reservation of Shares.*** The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.

16. ***Option Agreement.*** Options shall be evidenced by written Option agreements in such form as the Committee shall approve.

17. ***Shareholder Approval.*** Continuance of the Plan shall be subject to approval by the shareholders of the Company within twelve (12) months before or after the date the Plan is adopted. If such shareholder approval is obtained at a duly held shareholders' meeting, it may be obtained by the affirmative vote of the holders of a majority of the outstanding shares of the Company present or represented and entitled to vote thereon. The approval of such shareholders of the Company shall be (1) solicited substantially in accordance with Section 14(a) of the Exchange Act and the rules and regulations promulgated thereunder, or (2) solicited after the Company has furnished in writing to the holders entitled to vote substantially the same information concerning the Plan as that which would be required by the rules and regulations in effect under Section 14(a) of the Exchange Act at the time such information is furnished.

A-7

---

TABLE OF CONTENTS

18. ***Miscellaneous Provisions.*** An Optionee shall have no rights as a shareholder with respect to any Shares covered by his Option until the date of the issuance of a stock certificate to him for such shares.

19. ***Other Provisions.*** The stock option agreement authorized under the Plan shall contain such other provisions, including, without limitation, restrictions upon the exercise of the Option, as the Committee shall deem advisable. Any such stock option agreement shall contain such limitations and restrictions upon the exercise of the Option as

shall be necessary in order that such option will be an Incentive Stock Option as defined in Section 422 of the Code if an Incentive Stock Option is intended to be granted.

**20. *Indemnification of Committee.*** In addition to such other rights of indemnification as they may have as Directors or as members of the Committee, the members of the Committee shall be indemnified by the Company against the reasonable expenses, including attorneys' fees actually and necessarily incurred in connection with the defense of any action, suit or proceeding, or in connection with any appeal therein, to which they or any of them may be a party by reason of any action taken or failure to act under or in connection with the Plan or any Option granted thereunder, and against all amounts paid by them in settlement thereof (provided such settlement is approved by independent legal counsel selected by the Company) or paid by them in satisfaction of a judgment in any such action, suit or proceeding, except in relation to matters as to which it shall be adjudged in such action, suit or proceeding that such Board member is liable for negligence or misconduct in the performance of his duties; provided that within sixty (60) days after institution of any such action, suit or proceeding a Board member shall in writing offer the Company the opportunity, at its own expense, to handle and defend the same.

**21. *Application of Funds.*** The proceeds received by the Company from the sale of Common Stock pursuant to Options will be used for general corporate purposes.

**22. *No Obligation to Exercise Option.*** The granting of an Option shall impose no obligation upon the Optionee to exercise such Option.

**23. *Other Compensation Plans.*** The adoption of the Plan shall not affect any other stock option or incentive or other compensation plans in effect for the Company or any Subsidiary, nor shall the Plan preclude the Company from establishing any other forms of incentive or other compensation for employees and Directors of the Company or any Subsidiary.

#### **24. *Compliance with Section 409A of the Code***

**24.1. *Options Subject to Code Section 409A.*** Notwithstanding anything to the contrary contained in the Plan, any Option that constitutes, or provides for, a deferral of compensation subject to Section 409A of the Code (a Section 409A Award ) shall satisfy the requirements of Section 409A of the Code and this Section 24, to the extent applicable. The Option agreement with respect to a Section 409A Award (the 409A Award Agreement ) shall incorporate the terms and conditions required by Section 409A of the Code and this Section 24.

#### **24.2. *Distributions under a Section 409A Award.***

(a) Subject to subsection (b), any shares of Common Stock, cash or other property or amounts to be paid or distributed upon the grant, issuance, vesting, exercise or payment of a Section 409A Award shall be distributed in accordance with the requirements of Section 409A(a)(2) of the Code, and shall not be distributed earlier than:

(i) the Optionee's separation from service,

(ii) the date the Optionee becomes disabled,

(iii) the Optionee's death,

(iv) a specified time (or pursuant to a fixed schedule) specified under the 409A Award Agreement at the date of the deferral of such compensation,

(v) to the extent provided by the Secretary of the Treasury, a change in the ownership or effective control of the Company or a Subsidiary, or in the ownership of a substantial portion of the assets of the Company or a Subsidiary, or

(vi) the occurrence of an unforeseeable emergency with respect to the Optionee.

A-8

---

TABLE OF CONTENTS

(b) In the case of an Optionee who is a specified employee, the requirement of paragraph (a)(i) shall be met only if the distributions with respect to the Section 409A Award may not be made before the expiration of the applicable holding period under Section 409A, if any, after the Optionee's separation from service (or, if earlier, the date of the Optionee's death). For purposes of this subsection (b), an Optionee shall be a specified employee if such Optionee is a key employee (as defined in Section 416(i) of the Code without regard to paragraph (5) thereof) of a corporation any stock of which is publicly traded on an established securities market or otherwise, as determined under Section 409A(a)(2)(B)(i) of the Code and the Treasury Regulations thereunder.

(c) The requirement of paragraph (a)(vi) shall be met only if, as determined under Treasury Regulations under Section 409A(a)(2)(B)(ii) of the Code, the amounts distributed with respect to the unforeseeable emergency do not exceed the amounts necessary to satisfy such unforeseeable emergency plus amounts necessary to pay taxes reasonably anticipated as a result of the distribution, after taking into account the extent to which such unforeseeable emergency is or may be relieved through reimbursement or compensation by insurance or otherwise or by liquidation of the Optionee's assets (to the extent the liquidation of such assets would not itself cause severe financial hardship).

(d) For purposes of this Section 24, the terms specified herein shall have the respective meanings ascribed thereto under Section 409A of the Code and the Treasury Regulations thereunder.

**24.3. *Prohibition on Acceleration of Benefits.*** The time or schedule of any distribution or payment of any shares of Common Stock, cash or other property or amounts under a Section 409A Award shall not be accelerated, except as otherwise permitted under Section 409A(a)(3) of the Code and the Treasury Regulations thereunder.

**24.4. *Compliance in Form and Operation.*** A Section 409A Award, and any election under or with respect to such Section 409A Award, shall comply in form and operation with the requirements of Section 409A of the Code and the Treasury Regulations thereunder.

**25. *Singular, Plural; Gender.*** Whenever used herein, nouns in the singular shall include the plural, and the masculine pronoun shall include the feminine gender.

**26. *Headings, Etc., No Part of Plan.*** Headings of Articles and Sections hereof are inserted for convenience and reference; they constitute no part of the Plan.

**27. *Governing Law.*** The Plan shall be governed by and construed in accordance with the laws of the State of New York, except to the extent preempted by Federal law. The Plan is intended to comply with Rule 16b-3. Any provisions inconsistent with Rule 16b-3 shall be inoperative and shall not affect the validity of the Plan, unless the Board of Directors shall expressly resolve that the Plan is no longer intended to comply with Rule 16b-3.

Dated: March 14, 2008

A-9

---

TABLE OF CONTENTS

**APPENDIX B**

# ACURA PHARMACEUTICALS, INC. 2005 RESTRICTED STOCK UNIT AWARD PLAN<sup>(1)</sup>

## 1. General Description.

The Plan provides for grants of restricted stock units to employees and Non-Employee Directors of the Company and its Subsidiaries.

The purpose of the Plan is to attract, motivate and retain experienced and knowledgeable employees by offering additional stock based compensation and incentives to defer and potentially enhance their compensation and to encourage stock ownership in the Company and to attract and retain qualified directors.

This Plan is intended to comply with Section 409A of the Internal Revenue Code of 1986, as amended, in order to avoid compensation deferred under the Plan which is subject to Code Section 409A from being included in the gross income of Participants under Code Section 409A and the Plan shall be interpreted consistent with such intent.

## 2. Definitions.

The following definitions shall be applicable throughout the Plan:

**Board** means the Board of Directors of the Company.

**Cause** means, with respect to termination of a Participant's employment, or service as a Non-Employee Director, the occurrence of any one or more of the following:

(a) in the case of a (A) Non-Employee Director or (B) an employee where there is no employment, change in control or similar agreement in effect between the Participant and the Company or a Subsidiary at the time of the grant of the Restricted Stock Unit award, or where there is such an agreement but the agreement does not define **cause** (or similar words), the finding by the Board or the Committee, in the exercise of good faith and reasonable judgment, that: (1) except in the case of a Non-Employee Director, Participant breached his or her employment or service contract or any other agreement (whether verbal or written) with the Company, (2) Participant has been engaged in disloyalty to the Company, including, without limitation, fraud, embezzlement, theft, or proven dishonesty in the course of his or her employment or service with the Company; (3) Participant has been convicted of a felony; (4) Participant has committed gross negligence or willful misconduct in the course of his or her employment or service with the Company, or (5) Participant has disclosed trade secrets or confidential information of the Company to persons not entitled to receive such information.

(b) in the case of an employee where there is a written employment, change in control or similar agreement in effect between the Participant and the Company or a Subsidiary at the time of the grant of the Restricted Stock Unit award that defines **cause** (or similar words) the termination of an employment arrangement that is or would be deemed to be for **cause** (or similar words) as defined in such agreement.

**Change in Control** means in one or a series of related transactions any of the following: (a) the acquisition (other than solely from the Company) by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Exchange Act) other than the Company or any Subsidiary of the beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of more than sixty-six and 2/3 percent (66.66%) of the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the **Voting Securities**); (b) a reorganization,

Adopted by the Company's Board of Directors on December 22, 2005. Amended by the Board of Directors on October 26, 2006 (by amending Section 9(d), to allow for transfer of Restricted Stock Units under limited circumstances, subject to Board approval). Approved by shareholders at the 2006 Annual Meeting held on (1) December 14, 2006. Further amended by the Board of Directors on March 14, 2008 to increase the number of shares available for issuance under the Plan from 3,000,000 (after giving effect to a 1 for 10 reverse split effected December 5, 2007) to 3,500,000 (by amending Section 8).

B-1

---

TABLE OF CONTENTS

merger, consolidation, share exchange, recapitalization, business combination or similar combination involving the Company or its capital stock (a Business Combination), other than a Business Combination in which more than thirty-three and 1/3 percent (33.33%) of the combined voting power of the outstanding voting securities of the surviving or resulting entity immediately following the Business Combination is held by the persons who, immediately prior to the Business Combination, were the holders of the Voting Securities; (c) a sale or other transfer (other than license) of all or substantially all of the Company's assets (measured by the value or earning power of the assets), including, without limitation, the sale by the Company of its rights under license agreements or similar agreements relating to its technology (including the sale of royalty payment amounts payable to the Company or its shareholders under such agreements); (d) the license or similar agreement by the Company to a third party or third parties, in one or more transactions, of all rights in and to the Company's technology and, as a result of such transactions, all or substantially all of the Company's activities consist of monitoring such arrangements and collecting fees and payments due thereunder; or (e) a complete liquidation or dissolution of the Company.

Change in Control Section 409A shall mean a Change in Control Plan, except to the extent that (and only to the extent that) such Change in Control Plan does not qualify as a change (a) in the ownership or effective control of the Company, or (b) in the ownership of a substantial portion of the assets of the Company, under Section 409A of the Code.

Code means the Internal Revenue Code of 1986, as amended.

Committee shall mean the Committee, if any, appointed by the Board under Section 4 hereof.

Company means Acura Pharmaceuticals, Inc. and its successors.

Disability means

(a) in the case of a (A) Non-Employee-Director or (B) an employee where there is no employment, change in control or similar agreement in effect between the Participant and the Company or a Subsidiary at the time of the grant of the Restricted Stock Unit award, or where there is such an agreement but the agreement does not define disability (or similar words), then Disability means the Participant: (1) is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months; (2) is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than twelve (12) months, receiving income replacement benefits for a period of not less than three (3) months under an accident and health plan covering employees and/or directors of the Company; (3) is determined to be totally disabled by the Social Security Administration; or (4) any other permitted definition of disability under Section 409A of the Code and the regulations promulgated thereunder, and

(b) in the case where there is a written employment, change in control or similar agreement in effect between the Participant and the Company or a Subsidiary at the time of the grant of the Restricted Stock Unit award that defines disability (or similar words) the termination of an employment arrangement that is or would be deemed to be for disability (or similar words) as defined in such agreement.

Effective Date shall be the date this Plan is adopted by the Board.

Eligible Participant means a Non-Employee Director serving as a director on the date of grant or an employee employed by the Company or its Subsidiaries on the date of grant.

Exchange Act means the Securities Exchange Act of 1934, as amended.

Fair Market Value means the average of the closing bid and closing ask price of the Stock as reported on the OTC Bulletin Board or any successor principal market for the Stock on the applicable date, or if the Stock is not trading on the OTC Bulletin Board or an established securities market (within the meaning of Section 409A of the Code and the regulations promulgated thereunder), the fair market value of the Stock for the applicable date as determined by a reasonable valuation method selected by the Board or the Committee.

Non-Employee Director has the definition set forth in Rule 16b-3(b)(3)(i) of the Exchange Act.

B-2

---

### TABLE OF CONTENTS

Participant means each person who has been granted a Restricted Stock Unit award.

Plan means the Acura Pharmaceuticals, Inc. 2005 Restricted Stock Unit Award Plan, as set forth herein and as it may be amended from time to time.

Restricted Stock Unit Award Agreement means an agreement described in Section 5(a).

Restricted Stock Units or RSUs means an award of Stock Units credited pursuant to Section 5, which Stock Units are subject to vesting and other restrictions as set forth herein.

Securities Act means the Securities Act of 1933, as amended.

Stock means shares of common stock, par value \$.01 per share, of the Company, including any rights attendant thereto upon issuance of the shares, together with any restrictions, limitations or conditions of and to such rights and such other stock or other securities or property into which the Stock (or such rights) may be converted or for which it is exchanged or substituted (and any credits thereon), pursuant to Section 10.

Stock Unit means a non-voting unit of measurement that is (a) deemed for bookkeeping purposes to be equivalent to one outstanding share of Stock solely for purposes of determining benefits under the Plan, (b) credited to a Participant's Stock Unit Account pursuant to the grant of Restricted Stock Units under Section 5; and (c) payable solely in a share of Stock, on a one-for-one basis.

Stock Unit Account means the bookkeeping account maintained by the Company for each Eligible Participant that is credited with Stock Units in accordance with the Plan.

Subsidiary means any entity of which a majority of the outstanding voting stock or voting power is beneficially owned directly or indirectly by the Company.

## **3. Effective Date; Duration.**



The Effective Date shall be the date on which the Board adopts this Plan. The Plan shall continue in effect until all matters relating to Stock Units and the administration of the Plan have been completed and all payments of such compensation have been made.

## 4. Administration.

The Company's Board of Directors or a Committee appointed by the Board shall administer the Plan. If appointed by the Board, the Committee shall be constituted so as to permit the Plan to continue to comply with Rule 16b-3, as currently in effect or as hereafter modified or amended. The Committee appointed by the Board of Directors shall consist of not less than two members of the Board of Directors, to administer the Plan on behalf of the Board of Directors, subject to such terms and conditions as the Board of Directors may prescribe. Once appointed, the Committee shall continue to serve until otherwise directed by the Board of Directors. From time to time, the Board of Directors may increase the size of the Committee and appoint additional members thereof, remove members (with or without cause), and appoint new members in substitution therefor, fill vacancies however caused, or remove all members of the Committee and thereafter directly administer the Plan; provided, however, that at no time shall a Committee of less than two members administer the Plan. Notwithstanding anything to the contrary contained herein, no member of the Committee shall serve as such under this Plan unless such person is a Non-Employee Director within the meaning of Rule 16b-3(b)(3)(i) of the Exchange Act.

A majority of the entire Committee shall constitute a quorum, and the action of the majority of the Committee members present at any meeting at which a quorum is present shall be the action of the Committee. The Committee shall have all of the powers and duties set forth herein, as well as such additional powers and duties as the Board of Directors may delegate to it; provided, however, that the Board of Directors expressly retains the right in its sole discretion (i) to elect and to replace the members of the Committee, and (ii) to terminate or amend this Plan in any manner consistent with applicable law.

The Committee shall have the authority, subject to the provisions of this Plan, to establish, adopt and revise such rules, regulations and forms and agreements and to interpret the Plan and make all such determinations relating to the Plan as it may deem necessary or advisable. The Committee shall also have the authority, subject to the provisions of the Plan, to delegate ministerial, day-to-day administrative details and

B-3

---

### TABLE OF CONTENTS

non-discretionary duties and functions to officers and employees of the Company. The Committee's interpretation of the Plan or any awards granted pursuant hereto and all decisions and determinations by the Committee with respect to the Plan shall be final, binding, and conclusive on all parties. Notwithstanding any provisions of this Plan or any Restricted Stock Unit Award Agreement to the contrary, all discretionary interpretations, decisions or determinations of the Board or the Committee with respect to the Plan and all RSUs awarded under the Plan shall be made in accordance with the express terms of the Plan and applicable Restricted Stock Unit Award Agreement in the exercise of good faith and reasonable judgment.

Notwithstanding any contrary provision of this Section 4, the Board shall administer the Plan, and the Committee shall exercise no discretion with respect to any grants to Non-Employee Directors. In the administration of the Plan with respect to Non-Employee Directors, the Board shall have all of the authority and discretion otherwise granted to the Committee with respect to the administration of the Plan.

## 5. Restricted Stock Units.

(a) *Restricted Stock Units may be granted at any time and from time to time as determined by the Board or the Committee.* Each Restricted Stock Units grant will be evidenced by a Restricted Stock Award Agreement that will specify such other terms and conditions as Board or the Committee, in its sole discretion, will determine, including all other applicable terms, conditions and restrictions related to the grant, vesting and the number of Restricted Stock Units not otherwise set forth in this Plan.

(b) *Vesting Period.* The Board or the Committee shall determine the vesting of a Restricted Stock Unit award granted under Section 5(a), and shall set forth such vesting in the Restricted Stock Unit Award Agreement.

(c) *Acceleration of Vesting.* Notwithstanding Section 5(b), unless expressly provided otherwise in the Restricted Stock Unit Award Agreement, each Restricted Stock Unit award shall become fully and immediately vested and nonforfeitable to the Participant upon the occurrence of any of the following events:

(1) a Participant's service as an employee of the Company is terminated by the Company without Cause or due to Participant's death or Participant's Disability, or in the case of a Non-Employee Director, Participant's death or Disability or Participant is not renominated as a director (other than for Cause or refusal to stand for re-election) or is not elected by the Company's stockholders, if nominated; or

(2) a Change in Control Plan.

## 6. Dividend and Voting Rights.

Unless expressly provided for in a Participant's Restricted Stock Unit Award Agreement, a Participant shall have no rights as a stockholder of the Company, no dividend rights and no voting rights, with respect to the RSUs and any shares of Common Stock underlying or issuable in respect of such RSUs until such shares of Common Stock are actually issued to and held of record by the Participant. No adjustments will be made for dividends or other rights of a holder for which the record date is prior to the date of issuance of the stock certificate for such RSU.

## 7. Restrictions, Distributions and Changes to Distributions; Payment of Units.

(a) *Time and Manner of Distribution.* Payment of vested Stock Units in a Participant's Stock Unit Account in accordance with Section 7(b) shall be made on the earlier of (i) a Change in Control Section 409A, or (ii) January 1, 2011. In the event of a payment pursuant to a Change in Control Section 409A under Section 7(a)(i), such payment shall be made in a lump sum payment as soon as administratively practicable following consummation of said Change in Control Section 409A. In the event of a payment due to Section 7(a)(ii), such payment shall be made in four equal installments (twenty-five percent on each installment) on each of January 1, 2011, January 1, 2012, January 1, 2013 and January 1, 2014; provided, however, that in the event of a Change in Control Section 409A at any time after January 1, 2011 but prior to payment of all of Participant's Stock Units in the Participant's Stock Unit Account, all of Participant's undistributed Stock Units as of consummation of said Change in Control Section 409A shall be paid to Participant in a lump sum as soon as administratively practicable.

(b) *Payment of Units.* Upon the occurrence of the distribution events set forth in Section 7(a), the Company shall deliver a number of shares of Stock equal to the number of vested Stock Units to which the

---

TABLE OF CONTENTS

Participant is then entitled under the terms of the Plan and the Restricted Stock Unit Award Agreement upon receipt from Participant of the par value of such shares of Stock. In lieu of requiring cash payment of such par value, the Company may, in the Participant's sole discretion, accept payment of any such par value by withholding from Stock payments a number of whole shares of Stock whose value is equal to the amount of such par value. Valuation for this purpose shall be the Fair Market Value on the date of distribution.

(c) *Forfeiture of Unvested Units.* Except as provided in Section 5(c) of the Plan or in a Participant's Restricted Stock Unit Award Agreement, to the extent any portion of a Participant's RSUs have not become vested upon the date the Participant's services as an employee terminate, such RSUs shall be forfeited and the unvested portion of the RSU award shall automatically terminate without any other action by the Participant or the Participant's Beneficiary as the case may be and without payment of consideration by the Company.

## **8. Shares Subject to the Plan; Share Limits.**

*Shares Available for Issuance.* Subject to adjustment under Section 10, the aggregate number of shares of Stock that may be issued under the Plan shall not exceed three million five hundred thousand (3,500,000) shares (after giving effect to the reverse stock split effected December 5, 2007). Stock delivered by the Company to satisfy payment provisions under Section 7 of the Plan shall be shares of authorized and unissued shares of Stock and/or previously issued Stock held as treasury shares and shall be fully paid and non-assessable when issued. Shares issuable on payment of Stock Units shall be reserved for issue, and to the extent that awards terminate or are forfeited without payment in shares, the shares will be available for subsequent awards.

## **9. General.**

(a) *Government and Other Regulations.* The obligation of the Company to credit Stock Units, issue or deliver Stock or otherwise make payments under the Plan are subject to compliance with all applicable laws, rules, and regulations (including, without limitation, federal and state securities laws), and to such approvals by any listing, agency, or regulatory or governmental authorities as may, in the opinion of counsel for the Company, be necessary or advisable in connection therewith. Any securities issued or delivered under the Plan shall be subject to such restrictions, and the person acquiring such securities shall, if requested by the Company, provide such assurances and representations to the Company, as the Company may deem necessary or advisable to assure compliance with all applicable legal requirements.

(b) *Tax and Withholding.* The Company has the right to require the person receiving Stock to pay to the Company the amount of any federal, state and local taxes which the Company is required to withhold upon the delivery of Stock. In lieu of requiring cash payment of any such taxes, the Company shall, in the Participant's sole discretion, instead withhold from said Participant's Stock payments a number of shares of Stock whose value is equal to the amount of such taxes. Valuation for this purpose shall be the Fair Market Value on the date of distribution.

(c) Beneficiaries.

(1) *Beneficiary Designation.* Each Eligible Participant may designate in writing the Beneficiary or Beneficiaries (as defined in Section 9(c)(2)) whom such Eligible Participant desires to receive any amounts payable under the Plan after his or her death. Beneficiary designations shall be effective on the date such written designation is received by the Corporate Secretary. An Eligible Participant may from time to time change his or her designated Beneficiary or Beneficiaries without the consent of such Beneficiary or Beneficiaries by filing a new designation in writing with the

Corporate Secretary. However, if a married Eligible Participant wishes to designate a person other than his or her spouse as Beneficiary, such designation shall be consented to in writing by the spouse. The Eligible Participant may change any election designating a Beneficiary or Beneficiaries without any requirement of further spousal consent if the spouse's consent so provides. Notwithstanding the foregoing, spousal consent shall not be necessary if it is established that the required consent cannot be obtained because the spouse cannot be located or because of other circumstances prescribed by the Board or the Committee. The Company and the Board or the Committee may rely on the Eligible Participant's designation of a Beneficiary or Beneficiaries last filed in accordance with the terms of the Plan.

B-5

---

## TABLE OF CONTENTS

(2) Definition of Beneficiary. An Eligible Participant's Beneficiary or Beneficiaries shall be the person, persons, trust or trusts so designated by the Eligible Participant or, in the absence of such designation, entitled by will or the laws of descent and distribution to receive the Eligible Participant's benefits under the Plan in the event of the Eligible Participant's death, and shall mean the Eligible Participant's executor or administrator if no other Beneficiary is identified and able to act under the circumstances.

(d) Non-transferability. Except as provided in Section 9(c) and in this Section 9(d), a Participant's rights and interests under the Plan in respect of RSUs, including Stock deliverable under or in respect thereof, may not be assigned, pledged, or transferred. The Committee may, in its discretion, authorize all or a portion of the RSUs to be granted to a Participant to be on terms which permit transfer by such Participant to (i) the spouse, children or grandchildren of the Participant (the Immediate Family Members), (ii) a trust or trusts for the exclusive benefit of such Immediate Family Members, or (iii) a partnership in which such Immediate Family Members are the only partners, provided that (x) there may be no consideration for any such transfer, (y) subsequent transfers of transferred of RSUs shall be prohibited except those made by will or by the laws of descent or distribution, and (z) such transfer is approved in advance by the Committee. Following transfer, any such RSUs shall continue to be subject to the same terms and conditions as were applicable immediately prior to transfer, provided that for purposes of determining the party entitled to exercise under the RSU, the term Participant shall be deemed to refer to the transferee. The termination of service as an employee, non-employee director or consultant shall continue to be applied with respect to the original Participant, following which the RSUs shall be exchangeable for Stock by the transferee only to the extent, and for the periods specified in Section 7 of the Plan and in the Restricted Stock Unit Award Agreement.

(e) Expenses. All expenses incurred by the Company associated with adoption and administration of this Plan, including all legal expenses related to drafting this Plan and related documents, shall be borne solely by the Company.

(f) Titles and Headings. The titles and headings of the sections in the Plan are for convenience of reference only, and in the event of any conflict, the text of the Plan, rather than such titles or headings, shall control.

(g) Governing Law. The validity of the Plan or any of its provisions and any agreements entered into under the Plan shall be construed, administered and governed in all respects under the laws of the State of New York. If any provisions of the Plan shall be held by a court of competent jurisdiction to be invalid or unenforceable, the remaining provisions hereof shall continue to be fully effective.

(h) Limitation on Participants' Rights; Unfunded Plan. Participation in the Plan shall not give any person the right to continued employment or any rights or interests other than as expressly provided herein. No Participant shall have any right to any payment or benefit hereunder except to the extent provided herein. The Plan shall create only a contractual obligation on the part of the Company as to such amounts and shall not be construed as creating a trust or fiduciary relationship between the Company, the Board, the Committee, and any Participant or other person. Participants and their Beneficiaries shall have no legal or equitable rights, claims, or interest in any specific property or assets of the

Company. No assets of the Company shall be held under any trust, or held in any way as collateral security for the fulfilling of the obligations of the Company under this Plan. Any and all of the Company's assets shall be, and remain, the general unpledged, unrestricted assets of the Company. The Company's obligation under the Plan shall be merely that of an unfunded and unsecured promise of the Company to pay benefits in the future, and the rights of the Participants and Beneficiaries shall be no greater than those of unsecured general creditors.

(i) Rights with Respect to Stock Units. A Participant's Stock Unit Account shall be a memorandum account on the books of the Company. The Stock Units credited to such account shall be used solely as a device to determine the number of shares of Stock to be eventually distributed to the Participant, subject to applicable vesting requirements, in accordance with the Plan. The Stock Units shall not be treated as property or as a trust fund of any kind. No Participant shall be entitled to any voting dividend, or other stockholder rights with respect to Stock Units credited under the Plan.

B-6

---

## TABLE OF CONTENTS

(j) Restricted Stock Unit Award Agreements. Each Restricted Stock Unit award granted to an Eligible Participant under the Plan shall be evidenced by a writing approved by the Board or the Committee and will contain the terms and conditions consistent with the Plan as approved by the Board or the Committee relating to the RSUs. This Plan and each Restricted Stock Unit Award Agreement granted to an Eligible Participant under the Plan shall be binding upon, and inure to the benefit of, any successor or successors of the Company, except to the extent that the Board or the Committee and each Participant having executed a Restricted Stock Unit Award Agreement determine otherwise as evidenced by a writing signed by both parties.

(k) Plan Construction. By its approval of the Plan, the Board intends that the transactions contemplated by the Plan satisfy and be interpreted in a manner that satisfies the applicable requirements of Rule 16b-3 promulgated under the Exchange Act so that, among other transactions, the crediting of Stock Units and payment in Stock will be entitled to the benefits of Rule 16b-3 or other exemptive rules under the Exchange Act.

(l) Notices. Any notice to be given under the terms of this Plan shall be in writing and addressed to the Company at its principal office, to the attention of the Corporate Secretary, and to the Participant at his or her last address of record, or at such other address as either party may designate in writing to the other for the purposes of notices in respect of RSUs.

## **10. Changes in Capital Structure.**

Upon or in contemplation of any reclassification, recapitalization, stock split (including a stock split in the form of a stock dividend) or reverse stock split; any merger, combination, consolidation or other reorganization; any split-up; spin-off, or similar extraordinary dividend distribution in respect of the Stock (whether in the form of securities or property); any exchange of Stock or other securities of the Company, or any similar, unusual or extraordinary corporate transaction in respect of the Stock; or a sale of substantially all the assets of the Company as an entirety; then the Board shall, in such manner, to such extent (if any) and at such time as it deems appropriate and equitable in the circumstances in the Board's exercise of good faith and reasonable judgment, proportionately adjust any or all of (a) the number and type of shares of Stock (or other securities or property) that thereafter may be made the subject of Stock Units and Stock Unit Accounts (including the specific maximum and numbers of shares set forth elsewhere in the Plan), (b) the number, amount and type of shares of Stock (or other securities or property) payable in respect of Stock Units, and (c) and the number and type of Stock Units (both credited and vested) under the Plan.

## 11. Amendments and Termination.

The Board shall have the right to amend the Plan (including outstanding awards) in whole or in part from time to time or may at any time suspend or terminate the Plan; provided, however, that no amendment or termination shall cancel or otherwise adversely affect in any way, without his or her written consent, any Participant's rights with respect to Stock Units credited to his or her Stock Unit Account and no amendment or termination shall accelerate payment of any benefit which is subject to the rules of Section 409A of the Code in a manner that would violate the distribution rules of Section 409A of the Code. Notwithstanding the foregoing, Participant consent shall not be required to the extent that the Board determines that applicable law requires amendment or termination of the Plan to preserve the intended tax benefits to the Participants and the Company hereunder. Any amendments authorized hereby shall be stated in an instrument in writing, and all Participants (subject to any applicable consent requirement above) shall be bound thereby upon receipt of notice thereof. Changes contemplated by Section 10 shall not be deemed to constitute changes or amendments for purposes of this Section 11.

B-7

---

---

---