

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS  
TO BE HELD MAY 22, 2002

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To the Stockholders of A.P. Pharma, Inc.:

The Annual Meeting of Stockholders of A.P. Pharma, Inc. (the "Company") will be held at the corporate offices at 123 Saginaw Drive, Redwood City, California, on May 22, 2002, at 9:00 a.m. local time, for the following purposes:

1. To elect seven directors to hold office until the next Annual Meeting of stockholders and until their successors are elected.
2. To approve adoption of the Company's 2002 Equity Incentive Plan.
3. To transact such other business as properly may come before the meeting, or any adjournments or postponements of the meeting.

Only stockholders of record at the close of business on March 25, 2002, are entitled to notice of, and to vote at, the meeting and any adjournments or postponements of the meeting. A list of such stockholders will be open to examination by any stockholders at the Annual Meeting and for a period of ten days prior to the Annual Meeting during ordinary business hours at the offices of the Company located at 123 Saginaw Drive, Redwood City, California 94063.

BY ORDER OF THE BOARD OF DIRECTORS,

Julian N. Stern, Secretary

Redwood City, California  
April 17, 2002

- IMPORTANT -

WHETHER OR NOT YOU EXPECT TO ATTEND THE MEETING IN PERSON, PLEASE COMPLETE, SIGN, DATE AND RETURN THE PROXY CARD IN THE ENCLOSED POSTPAID ENVELOPE OR FOLLOW THE TELEPHONE OR INTERNET VOTING INSTRUCTIONS ON THE PROXY CARD AS SOON AS POSSIBLE. THANK YOU FOR ACTING PROMPTLY.

A.P. PHARMA, INC.  
123 Saginaw Drive  
Redwood City, California 94063  
(650) 366-2626

PROXY STATEMENT

The enclosed proxy is solicited on behalf of the Board of Directors (the "Board") of A.P. Pharma, Inc. ("APP" or the "Company"), a Delaware corporation. The proxy is solicited for use at the Annual Meeting of Stockholders (the "Annual Meeting") to be held at 9:00 a.m. local time on May 22, 2002, at the corporate offices at 123 Saginaw Drive, Redwood City, California. The approximate date on which this proxy statement and the accompanying notice and proxy are first being mailed to stockholders is April 17, 2002.

VOTING

Only stockholders of record at the close of business on March 25, 2002, are entitled to notice of, and to vote at, the Annual Meeting and any adjournments or postponements thereof. At the close of business on that date, the Company had outstanding 20,365,687 shares of its Common Stock, \$.01 par value (the "Common Stock"). Holders of a majority of the outstanding shares of Common Stock of the Company, either present in person or by proxy, will constitute a quorum for the transaction of business at the Annual Meeting.

Holders of Common Stock are entitled to one vote for each share of Common Stock held. In the election of directors, the seven nominees receiving the highest number of affirmative votes of the shares present and voting at the Annual Meeting at which a quorum is present will be elected directors.

Abstentions are included in the determination of whether a quorum is present at the meeting and are counted in tabulations of the votes cast on proposals presented to stockholders and have the same effect as negative votes. Proxies marked to withhold authority for all directors will not be

counted in the election of directors. If a broker indicates on a proxy that it does not have discretionary authority as to certain shares to vote on a particular matter (a broker non-vote), while those shares will be included in the determination of whether a quorum is present, broker non-votes will have no effect on the election of directors or proposal number two to approve adoption of the 2002 Equity Incentive Plan.

#### REVOCABILITY OF PROXIES

Proxies which are properly executed and received by the Company before the Annual Meeting will be voted at the Annual Meeting. Any stockholder giving a proxy has the power to revoke the proxy at any time prior to its exercise. A proxy can be revoked by an instrument of revocation delivered prior to the Annual Meeting to the Secretary of the Company, by a duly executed proxy bearing a later date or time than the date or time of the proxy being revoked, or at the Annual Meeting if the stockholder is present and elects to vote in person. Mere attendance at the Annual Meeting will not serve to revoke a proxy.

#### SOLICITATION OF PROXIES

Solicitation of proxies may be made by directors, officers and other employees of the Company by personal interview, telephone, telegraph, telefax or electronic communications. No additional compensation will be paid for any such services. Costs of solicitation will be borne by the Company. APP will, upon request, reimburse the reasonable fees and expenses of banks, brokerage houses or other nominees or fiduciaries for forwarding proxy materials to, and obtaining authority to execute proxies from, beneficial owners for whose accounts they hold shares of Common Stock.

#### PROPOSAL ONE--ELECTION OF DIRECTORS

##### COMMON STOCK OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth beneficial Common Stock ownership as of March 25, 2002, by (i) each person who is known by the Company to own beneficially more than 5% of the outstanding shares of Common Stock, (ii) each director, including nominees, and each executive officer named in the Summary Compensation Table included in the Proxy Statement, and (iii) all executive officers and directors as a group. Each person has sole investment and voting power with respect to the shares indicated, subject to community property laws where applicable and except as otherwise set forth in the footnotes to the table.

NAME	NUMBER OF SHARES(1)	PERCENT OF CLASS(1)
John Barr, Ph.D.(2)	79,817	*
Stephen Drury(3)	72,622	*
Paul Goddard, Ph.D.(4)	106,389	*
Jayne Lange(5)	12,500	*
Michael O'Connell(6)	455,183	2.2
Peter Riepenhausen(7)	145,620	*
Toby Rosenblatt(8)	261,433	1.3
Gordon Sangster(9)	169,991	*
Gregory Turnbull(10)	142,837	*
Dennis Winger(11)	119,995	*
Citigroup, Inc.(12) 388 Greenwich Street New York, NY 10013	4,264,310	20.9
Wellington Management(13) 75 State Street Boston, MA 02109	1,620,500	8.0
Officers and Directors as a group(10 persons) (2)(3)(4)(5)(6)(7)(8)(9)(10)(11)	1,566,387	7.7

\* Less than one percent.

- (1) Assumes the exercise of all outstanding options to purchase Common Stock held by such person or group to the extent exercisable on or before May 25, 2002, and that no other person has exercised any outstanding stock options.
- (2) Includes 74,793 shares underlying exercisable stock options.
- (3) Includes 38,750 shares underlying exercisable stock options.
- (4) Includes 41,389 shares underlying exercisable stock options

options and 35,000 shares of restricted stock granted in October, 2001.

- (5) Represents 12,500 shares underlying exercisable stock options.
- (6) Includes 421,877 shares underlying exercisable stock options.
- (7) Includes 35,300 shares held in family trust and 90,000 shares underlying exercisable stock options.
- (8) Includes 90,000 shares underlying exercisable stock options.
- (9) Includes 165,488 shares underlying exercisable stock options.
- (10) Includes 90,000 shares underlying exercisable stock options.
- (11) Includes 105,000 shares underlying exercisable stock options.
- (12) Based solely on information contained in a Schedule 13G dated January 14, 2002, and includes 1,672,300 shares held by Smith Barney Fund Management LLC and 2,578,610 shares held by Salomon Smith Barney, Inc.
- (13) Based solely on information contained in a Schedule 13G dated February 14, 2002.

#### ELECTION OF DIRECTORS

Seven directors are to be elected to the Board at the Annual Meeting, each to serve for a one year term until the Annual Meeting to be held in 2003, and until his or her successor has been elected and qualified. All the nominees presently are directors of APP. It is intended that proxies received will be voted "FOR" the election of the nominees, unless marked to the contrary.

The Board has no reason to believe that any of the nominees will be unable or unwilling to serve as a director if elected. If any nominee should become unavailable prior to the election, the accompanying proxy will be voted for the election of any nominee who is designated by the present Board of Directors to fill the vacancy.

#### INFORMATION CONCERNING THE BOARD OF DIRECTORS:

The nominees for Directors of APP and their ages and position with the Company are as follows:

NAME	AGE	POSITION WITH COMPANY	DIRECTOR SINCE
Paul Goddard, Ph.D.	52	Chairman	2000
Stephen A. Drury (1)	64	Director	1999
Michael O'Connell	52	President and Chief Executive Officer	2000
Peter Riepenhausen (2)	65	Director	1991
Toby Rosenblatt (1)(2)	63	Director	1983
Gregory Turnbull (1)(2)	63	Director	1986
Dennis Winger (1)	54	Director	1993

(1) Member of the Finance and Audit Committees of the Board.

(2) Member of the Compensation and Stock Option Committee of the Board.

Paul Goddard -- chairman of APP board of directors since November 2000. From 1998 to 2000, Dr. Goddard was president and chief executive officer of Elan's pharmaceutical division. From 1991 to 1998 Dr. Goddard served as chairman and chief executive officer of Neurex. In 1998, Neurex was acquired by Elan. Prior to Neurex, Dr. Goddard held various senior management positions at SmithKline Beecham.

Stephen A. Drury -- director of APP since May 1999. Mr. Drury is currently a healthcare financial advisor and a private investor. Prior to his retirement in 1997, he was executive vice president and a director of Owen Healthcare since 1992 and senior vice president and chief financial officer of Integrated Health Services, Inc. from 1989 until 1992. Prior to that, Mr. Drury served as senior vice president of Thomson McKinnon Securities and managing director of its Healthcare Capital Markets Group from 1985 to 1989.

Michael O'Connell -- director since May 2001 and chief executive officer and president of APP since August 2000; he originally joined APP in July 1992 as vice president and chief financial officer. From 1980 to 1992, Mr. O'Connell served with The Cooper Companies, Inc. (formerly CooperVision,

Inc.) in a number of financial positions including vice president and corporate controller.

Peter Riepenhausen -- director of APP since April 1991. Mr. Riepenhausen is currently chairman, Europe, of Align Technologies, Inc. and a business consultant. He was president and chief executive officer of ReSound Corporation from 1994 to 1998. He serves as a director of Audimed, Germany and GAP AG, Germany. He also served as a director of Caradon (Europe) plc from April 1994 until September 1998.

Toby Rosenblatt -- director of APP since September 1983. Mr. Rosenblatt is president of Founders Investments, Ltd which is involved in private investment activities. Mr. Rosenblatt also serves as a director of State Street Research Mutual Funds and Met Life Metropolitan Series Mutual Funds and is a trustee of numerous civic and educational institutions.

Gregory Turnbull -- director of APP since February 1986. Mr. Turnbull is currently a business consultant and a director of Planar Systems, Inc. Previously, he was a general partner of Cable & Howse Ventures, a venture capital organization, of which he is currently a special limited partner.

Dennis Winger -- director of APP since February 1993. Mr. Winger is senior vice president and chief financial officer of Applera Corporation. From 1989 to 1997, Mr. Winger was senior vice president, finance and administration and chief financial officer of Chiron Corporation. He was also a member of Chiron's Strategy Committee.

#### MEETINGS AND COMMITTEES OF THE BOARD

The Board of Directors met four times during 2001. All directors participated in at least 75% of the total number of meetings of the Board and of the committees of the Board on which each served, except for Mr. Winger.

The Board has a Finance Committee, an Audit Committee and a Compensation and Stock Option Committee. The Finance and Audit Committees each met six times during the last fiscal year, including quarterly meetings of the Audit Committee for review of the Company's financial results, and consisted of Messrs. Drury, Rosenblatt, Turnbull and Winger. The Audit Committee recommends engagement of the Company's independent auditors and reviews the scope and results of the annual independent audit of the Company's books and records. The Committee is also responsible for reviewing the Company's accounting principles and its system of internal accounting controls. See the Audit Committee Report included in this Proxy Statement. The Finance Committee is responsible for reviewing the Company's plans for providing appropriate financial resources to sustain the Company's operations including review of the Company's strategic plan and annual operating budget. The Compensation and Stock Option Committee, which met five times during the year, consisted of Messrs. Riepenhausen, Rosenblatt and Turnbull. The function of the Compensation and Stock Option Committee is to propose and review the compensation policies of the Company and to administer the Company's stock option and stock purchase plans. Mr. Turnbull joined the Compensation and Stock Option Committee in May 2001.

#### COMPENSATION OF DIRECTORS

Each nonemployee director of the Company annually has been granted an option to acquire 10,000 shares of Common Stock, under the Company's 1992 Stock Option Plan. In addition, each nonemployee director elected after the Company's initial public offering in 1987 received a one-time grant to acquire 25,000 shares when first elected as a director. Nonemployee directors of the Company also receive \$12,000 per year, \$1,000 for each meeting of the Board of Directors attended and \$500 for each committee meeting attended on a date other than the date of a regularly scheduled Board meeting. Subsequent to July 1, 2000, all compensation was payable in unregistered Common Stock of the Company valued at the closing price of the Company's Common Stock on the last trading date of each quarter. Certain directors of the Company have received consulting fees in prior years.

#### COMPLIANCE WITH SECTION 16(A) OF THE SECURITIES EXCHANGE ACT

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's officers and directors, as well as any holders of more than 10% of the Company's Common Stock, to file with the Securities and Exchange Commission certain reports of ownership and reports of changes in ownership of Common Stock and other equity securities of the Company. Based solely on review of such reports and certain representations furnished to it, the Company believes that during the fiscal year ended December 31, 2001, except for Mr. Peter Riepenhausen who was delayed in filing a Form 4, all Section 16(a) filing requirements applicable to its officers and directors were satisfied.

EXECUTIVE COMPENSATION

The following Summary Compensation Table shows the total compensation for fiscal years 2001, 2000 and 1999 of the chief executive officer and the other most highly compensated executive officers whose salary exceeded \$100,000 in 2001.

SUMMARY COMPENSATION TABLE

NAME AND POSITION	YEAR	ANNUAL COMPENSATION		LONG-TERM COMPENSATION AWARDS	ALL OTHER COMPENSATION
		SALARY (\$)	BONUS (\$)	SECURITIES UNDERLYING OPTIONS (#)	
Michael O'Connell President and Chief Executive Officer	2001	291,058	67,500	25,000	5,100(1)
	2000	261,769	125,000	150,000	5,100(1)
	1999	242,423	33,000	0	4,800(1)
John Barr, Ph.D. Vice President, Research and Development	2001	182,288	94,750(2)	35,000	5,100(1)
	2000	146,385	13,000	50,000	4,469(1)
	1999	125,142	10,000	0	3,741(1)
Jayne Lange (3) Vice President, Business and Development	2001	120,750	24,000	50,000	3,060(1)
	2000	N/A	N/A	N/A	N/A
	1999	N/A	N/A	N/A	N/A
Gordon Sangster Chief Financial Officer	2001	193,542	38,500	20,000	5,100(1)
	2000	182,183	65,000	50,000	5,100(1)
	1999	161,281	15,000	0	4,800(1)

- (1) The stated amounts are Company matching contributions to the A.P. Pharma 401K Plan. In 2001, the Company made matching cash contributions equal to 50% of each participant's contribution during the plan year up to a maximum amount equal to the lesser of 3% of each participant's annual compensation or \$5,100.
- (2) Dr. Barr was paid \$52,500 in January 2001 as a retention bonus in accordance with a prior agreement, based on Dr. Barr's continuing employment with the Company following the sale of the Company's cosmeceutical business to RP Scherer on July 25, 2000.
- (3) Ms. Lange joined the Company in May 2001 and is compensated at an annual rate of \$195,000.

The following table sets forth certain information with respect to options granted during 2001 to the executive officers named in the Summary Compensation Table.

STOCK OPTION GRANTS IN 2001

REALIZABLE	POTENTIAL
INDIVIDUAL GRANTS	VALUE AT ASSUMED ANNUAL RATES OF STOCK PRICE APPRECIATION FOR OPTION TERM(1)
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% OF TOTAL OPTIONS GRANTED	

NAME 10%(\$)	SHARES	TO	EMPLOYEES		5%(\$)
	UNDERLYING OPTIONS GRANTED (#)(2)	FISCAL YEAR	IN EXERCISE PRICE (\$/SH)	EXPIRATION DATE	
Michael O'Connell 75,878	25,000	6.8	\$3.125	01/25/11	18,591
John Barr, Ph.D. 111,562	35,000	9.5	\$2.000	08/21/11	44,022
Jayne Lange 246,233	50,000	13.5	\$3.090	05/21/11	97,164
Gordon Sangster 63,749	20,000	5.4	\$2.000	08/21/11	25,156

(1) Potential realizable value is based on an assumption that the price of the

Common Stock appreciates at the annual rate shown (compounded annually) from the date of grant until the end of the ten year option term. The numbers are calculated based on the requirements promulgated by the Securities and Exchange Commission ("SEC") and do not reflect the Company's estimate of future stock price growth.

(2) The options granted under the Company's 1992 Stock Plan typically vest over 4 years at 25% annually. Payments on exercise, including any taxes

the Company is required to withhold, may be made in cash, by a full recourse promissory note or by tender of shares. Options are granted

at fair market value on the date of grant.

The following table sets forth certain information with respect to the value of options held at fiscal year-end by the executive officers named in the Summary Compensation Table. No options were exercised during 2001 by any of the named executive officers.

#### AGGREGATED 2001 YEAR-END OPTION VALUES

NAME	NUMBER OF UNEXERCISED OPTIONS AT 2001 YEAR-END		VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT FISCAL YEAR-END (1)	
	EXERCISABLE (#)	UNEXERCISABLE (#)	EXERCISABLE (\$)	UNEXERCISABLE (\$)
Michael O'Connell	388,645	136,355	0	0
John Barr, Ph.D.	62,708	72,292	2,334	25,666
Jayne Lange	0	50,000	0	0
Gordon Sangster	153,055	61,945	1,334	14,666

(1) Market value of underlying securities at fiscal year-end minus the exercise price of "in-the-money" options.

#### REPORT OF THE AUDIT COMMITTEE

The Audit Committee of the Board of Directors operates under a written charter adopted by the Board of Directors. The Audit Committee, on behalf of the Board of the Directors, provides general oversight of the Company's financial accounting and reporting process, including the system of internal controls. The Audit Committee also reviews and appraises the audit effort of the Company's independent accountants and provides an open avenue of communication among the independent accountants, financial and senior management and the Board of Directors. Each of the members of the Audit Committee is independent, as defined under the listing standards of NASDAQ.

The Company's management has primary responsibility for preparing the Company's financial statements and for the Company's financial reporting process. The Company's independent auditors, Ernst & Young LLP, are responsible for expressing an opinion on the conformity of the Company's audited financial statements to accounting principles generally accepted in the United States of America.

In this context and in connection with the audited financial statements contained in the Company's 2001 Annual Report on Form 10-K, the Audit Committee:

reviewed the audited financial statements with the Company's management, including a discussion of the quality of the accounting principles. In addition, the Committee met with management on a quarterly basis, to review the quarterly financial statements prior to their release;

discussed with Ernst & Young LLP, the Company's independent auditors, their judgment as to the quality of the Company's accounting principles, as well as certain matters related to the conduct of the audit, as required by Statement of Auditing Standards No. 61, Communication with Audit Committees;

met with the independent auditors, with and without management present, to discuss the results of their audit, their evaluations of the Company's internal controls, and the overall quality of the Company's financial reporting;

reviewed the written disclosures and the letter from Ernst & Young LLP required by Independence Standard Board Standard No. 1, "Independence Discussions with Audit Committees," discussed with the auditors their independence from the Company, and concluded that the non-audit services performed by Ernst & Young LLP are compatible with maintaining their independence;

instructed the independent auditors that the Committee expects to be advised if there are any subjects that require special attention.

Based on the review and discussions described above, the Audit Committee recommended to the Board of Directors that the Company's audited consolidated financial statements for the fiscal year ended December 31, 2001 be included in the Company's Annual Report on Form 10-K for the year ended December 31, 2001, for filing with the SEC, and the Board of Directors approved such inclusion. Based on the Audit Committee's recommendation, the Board has also selected Ernst & Young LLP as the Company's independent auditors for the fiscal year ending December 31, 2002.

Audit Committee  
Stephen Drury  
Toby Rosenblatt  
Gregory Turnbull  
Dennis Winger

#### Relationship with Independent Accountants

As reported on Form 8-K, dated December 12, 2001, the Audit Committee of the Board of Directors authorized the termination of KPMG LLP as auditors of the Company effective December 13, 2001 and engaged Ernst & Young LLP as the Company's independent auditors to replace KPMG LLP. A representative from Ernst & Young LLP will be present at the Annual Meeting.

The reports of KPMG LLP on the Company's financial statements for the past two fiscal years did not contain an adverse opinion or a disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope, or accounting principles.

In connection with the audits of the Company's financial statements for each of the two fiscal years ended December 31, 2000 and December 31, 1999, there were no disagreements with KPMG LLP on any matters of accounting principles or practices, financial statement disclosure, or auditing scope and procedures which, if not resolved to the satisfaction of KPMG LLP, would have caused KPMG LLP to make reference to the matter in their report.

Prior to its termination, KPMG performed the review of the Company's quarterly consolidated financial statements for the year 2001. Ernst and Young performed the year-end audit of the Company's consolidated financial statements for the year 2001. The aggregate fees billed for 2001 for each of the following categories of services are as follows:

Review of the Company's 2001	
quarterly financial statements - KPMG	\$28,735
All other services - KPMG	\$ 5,700

Year-end audit - Ernst and Young  
All other services - Ernst and Young

\$60,000  
\$20,000

"All other services" includes tax planning and review of tax returns of the Company.

#### REPORT OF THE COMPENSATION AND STOCK OPTION COMMITTEE

The Compensation and Stock Option Committee of the Board of Directors (the "Committee") is responsible for establishing compensation policies applicable to the Company's executive officers and, pursuant to such policies, determining the compensation payable to the Company's chief executive officer and other executive officers of the Company. The Committee consists of Peter Riepenhausen, Toby Rosenblatt and Greg Turnbull, each of whom is a nonemployee director of the Company. In determining compensation policies, the Committee has access to compensation surveys for companies which compete with the Company in the recruitment and retention of senior executives as well as other executive compensation information and data. The following report relates to compensation payable to the Company's executive officers for the year ended December 31, 2001.

#### COMPONENTS OF COMPENSATION

There are three components of compensation payable to the Company's executive officers: base salary, equity-based incentive compensation in the form of stock options and restricted stock awards and annual incentive compensation in the form of cash bonuses.

#### COMPENSATION POLICIES

The Company's compensation policies for all employees, including executive officers, are designed to provide targeted compensation levels that are competitive with those of companies of similar size, with whom the Company must compete in the recruitment of senior personnel. The Committee also seeks to tie incentive cash bonuses to the achievement of pre-established performance objectives for the Company approved by the Committee and the Board of Directors, and to use equity-based compensation to promote equity-ownership in the Company at levels deemed appropriate by the Committee for executive officers and employees. The goals of the Committee are to align compensation with the Company's objectives and performance, and to enable the Company to attract, retain and reward executives and employees who contribute to the long-term success of the Company. The Company does not believe that compensation payable by it will be subject to the limitations on deductibility provided under Section 162(m) of the Internal Revenue Code.

#### BASE SALARIES

The salary component of executive compensation is based on the executive's level of responsibility for meeting the Company's objectives and performance, and comparison to similar positions in the Company and comparable companies. Base salaries for executive officers are reviewed and adjusted annually based on information regarding competitive salaries, including salary survey data provided by third parties. Individual increases are established by the Committee (taking into account recommendations of the chief executive officer concerning the overall effectiveness of each executive).

#### CASH BONUSES

Cash bonuses for executive officers are determined under the Company's new bonus plan based on management by objectives ("MBO"). The MBO plan, adopted by the Committee in January 2001, establishes annual corporate goals and a target bonus for all employees, including for each executive officer, which is a percentage of base salary. The percentage of the target bonus that is paid to each officer is dependent upon the percentage achievement of corporate goals. Achievement of corporate goals is determined at the end of the year and related bonuses are paid in the subsequent year. Bonuses earned by the executive officers for achieving a percentage of the 2001 corporate goals were paid in February 2002.

#### EQUITY AWARDS

The Company's compensation policies recognize the importance of stock ownership by senior executives and equity-based incentive compensation is an integral part of each executive's compensation. The Committee believes that the opportunity for stock appreciation through stock options which vest over time promotes the relationship between long-term interests of executive officers and stockholders. The size of specific options grants takes into account the executive officer's salary, number of options previously granted, as well as shares of Common Stock held, and the contributions to the Company's success.



In 1998, the Company's 1992 Stock Plan was amended to also permit the awards of restricted stock. No restricted stock awards were granted to executive officers in 2001.

#### COMPENSATION PAYABLE TO CHIEF EXECUTIVE OFFICER

The 2001 salary for Mr. O'Connell, the Company's president and chief executive officer, was determined principally by evaluating his performance in his leadership role in the Company and his contributions in executing the strategic and operating plan of the Company and taking into consideration competitive compensation levels for comparable companies. The Compensation Committee and Board of Directors increased his base salary of \$285,000 to \$300,000 effective September 1, 2001. In 2001, the Compensation Committee and Board of Directors approved the grant to Mr. O'Connell of stock options to acquire an aggregate of 25,000 shares of Common Stock. As of March 25, 2002, Mr. O'Connell held presently exercisable stock options to purchase 407,083 shares and, including options, beneficially owns as of that date 440,389 shares of the Company's Common Stock.

Compensation and Stock Option Committee  
Peter Riepenhausen  
Toby Rosenblatt  
Gregory Turnbull

#### PERFORMANCE GRAPH

The rules of the SEC require APP to include in this Proxy Statement a line graph presentation comparing cumulative five year stockholder returns, on a dividend reinvested basis, with a broad based equity index and a published industry index. The Company selected the S&P 500 Stock Index and Russell 2000 for purposes of the comparison which appears below. The graph assumes that \$100 was invested in APP stock and each index on December 31, 1996, with all dividends reinvested. Past stock performance is not necessarily indicative of future results.

	12/96	12/97	12/98	12/99	12/00	12/01
	-----	-----	-----	-----	-----	-----
A.P. PHARMA, INC.	100	86	70	45	31	36
S&P 500	100	133	171	208	189	166
RUSSELL 2000	100	122	119	145	140	143

#### CERTAIN TRANSACTIONS

In 2000, the Company approved a Retention Incentive Plan ("Retention Plan") for Mr. O'Connell. The purpose of the Retention Plan was to encourage Mr. O'Connell to continue his employment with the Company, enhance his ability to perform effectively and provide the Company with the benefit of his continued service. Under the Retention Plan, the Company entered into a retention agreement with Mr. O'Connell providing that he will be eligible for certain benefits if his employment is terminated under specified circumstances. If Mr. O'Connell's full-time employment with the Company is terminated by the Company (other than for cause) or by the executive for good reason (due to material reduction in the executive's authority or responsibility, base salary or other compensation or employee benefits), he will be retained as a part-time employee for a period ranging from a minimum of 12 months to a maximum of 24 months (the "Retention Period"). During the Retention Period, Mr. O'Connell will receive continuation of salary, payable one-half in a lump sum following termination of full-time employment and the remainder ratable over the Retention Period and an annual bonus equal to the bonus paid during the immediately preceding 12-month period.

Under the terms of the Company's agreement with Dr. Goddard in the year 2000, he received a stock option grant to acquire 75,000 shares of the Company's Common Stock. Twenty-five percent of the options vested at the end of twelve months and the balance vest in equal monthly installments for the next 36 months. The agreement provided that Dr. Goddard would receive additional option grants each year of 20,000 shares while he serves as chairman. In addition, he receives compensation of \$100,000 per year.

In 2001, the agreement with Dr. Goddard was amended to increase his involvement in the Company's activities. As compensation for his increased involvement, he received a restricted stock award in October 2001 of 35,000 shares of the Company's Common Stock which vested in March 2002, and a stock option grant to acquire 70,000 shares of the Company's Common Stock. The options will vest monthly over a period of two years beginning in April 2002. Additionally, Dr. Goddard's cash compensation was increased to \$150,000 per

year beginning April 1, 2002.

During 2001, no consulting fees were paid to directors.

PROPOSAL TWO--APPROVAL OF ADOPTION OF  
A.P. PHARMA 2002 EQUITY INCENTIVE PLAN

The Company's 1992 Stock Option Plan expired on March 24, 2002. This plan was intended to strengthen the Company by providing added incentive to officers, directors, and consultants for high levels of performance. As of March 24, 2002, directors, officers, employees and consultants held unexercised options covering 3,325,792 shares of Common Stock with an average exercise price of \$5.33, of which options covering 722,683 shares are due to expire by July 2002.

The board believes that it is in the best interest of the Company to approve the adoption of the 2002 Equity Incentive Plan (the "2002 Plan"). Subject to shareholder approval, under the terms and conditions of the 2002 Plan, an aggregate of 500,000 shares of Common Stock will be reserved for issuance thereunder. The 2002 Plan authorizes the Company to grant options and restricted stock (collectively, "awards") to eligible employees, directors and consultants. The following description of the 2002 Plan is a summary and is qualified by reference to the complete text of the 2002 Plan.

Summary Description of the 2002 Plan

The 2002 Plan is intended to strengthen the Company by allowing selected employees, directors and consultants to participate in the Company's future growth and success by granting them stock options in order to retain, attract and motivate them. The Board has ultimate responsibility for administering the 2002 Plan, but will delegate this authority to a committee of the board or executives of the Company (the "Committee"), subject to certain limitations. The Committee will have broad discretion to determine the amount and type of awards and terms and conditions of the awards. Individual grants will generally be based on a person's present and potential contribution to the Company.

As of March 29, 2002, the Company had approximately 38 employees and 6 non-employee directors who would be eligible to participate in the 2002 Plan. The grant of awards is based upon a determination made by the Committee after a consideration of various factors. The Company currently cannot determine the nature and amount of any awards that will be granted in the future to any eligible individual or group of individuals, although the Board currently expects each year to grant stock options for 10,000 shares of Common Stock to each nonemployee director. In addition, the maximum number of shares that can be granted under the 2002 Plan during any calendar year to any single optionee is 250,000. The Company believes that with this limitation and other provisions of the 2002 Plan, options and stock awards granted under the 2002 Plan will generate "qualified performance-based compensation" within the meaning of section 162(m) of the Internal Revenue Code and will therefore not be subject to the \$1,000,000 cap on deductibility for federal income tax purposes of certain compensation payments in excess of \$1,000,000. See "Federal Income Tax Consequence of Awards and Exercises under the 2002 Plan" below.

Awards may be granted in the form of options and restricted stock. Any award may be granted either alone or in addition to other awards granted under the 2002 Plan. The 2002 Plan will expire in 2012, but options outstanding under the 2002 Plan may extend beyond that date.

Options

Stock options granted under the 2002 Plan may be incentive stock options under Section 422 of the Internal Revenue Code ("ISOs") or non-qualified stock options ("NQOs"). The exercise price of ISOs may not be less than the fair market value of the shares subject to the option on the date of grant. The term of any ISO or NQO granted under the plan may not exceed 10 years. Certain other limitations are also applicable to ISOs in order to take advantage of the favorable tax treatment that may be available for ISOs. The consideration payable upon exercise of an option may be paid in cash, shares of stock, or by promissory note as authorized by the Committee.

Restricted Stock

Restricted stock awards consist of non-transferable shares of Common Stock. The restrictions on transfer can lapse based on service, performance or other criteria determined by the Committee, which may not be waived or accelerated except in the event of a change of control or a fundamental transaction such

as a merger in which the Company is not the survivor. The lapse of restrictions on restricted stock awards cannot be less than three years or more than ten years. The purchase price of the restricted stock must be at least par value of the Common Stock and may be paid in cash, shares of stock, or by promissory note as authorized by the Committee.

#### General

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The consideration payable for, upon exercise of, or for tax payable in connection with, an award may be paid in cash, by promissory note of the participant, or by delivery of other property, including securities of the Company, as authorized by the Committee. The Company generally will not receive any consideration upon the grant of any awards. Awards generally may be exercised at any time within three months after a participant's employment by, or consulting relationship with, the Company terminates (but, only to the extent exercisable or payable at the time of termination). If termination is due to the participant's death, retirement or disability, the award may be exercised for one year thereafter. Shares issued under an award may be subject to a right of repurchase by the Company. Except as specifically provided in an award agreement, no award is assignable or otherwise transferable by a participant other than by will or by the laws of descent and distribution.

The Board may amend, alter or discontinue the 2002 Plan or any award at any time, but, except under limited circumstances, the consent of a participant is required if the participant's rights under an outstanding award would be impaired. In addition, to the extent required for the 2002 Plan to satisfy the conditions of Rule 16b-3 under the Securities Exchange Act of 1934 or, with respect to provisions solely as they relate to ISOs, to the extent required for the 2002 Plan to comply with Section 422 of the Internal Revenue Code, the stockholders of the Company must approve any amendment, alteration or discontinuance of the 2002 Plan that would: (i) increase the total number of shares reserved under the 2002 Plan; (ii) change the class of participants eligible to participate in the 2002 Plan; or (iii) materially increase the benefits accruing to participants under the 2002 Plan.

In the event of a "change in control" of the Company, as defined in the 2002 Plan, the Board may, subject to certain limitations, accelerate the vesting provisions of awards or may cash out the awards. A "change in control" is defined to include the acquisition by a group of 30% or more of the total combined voting power or value of the Company; as a result of a contested election of Company Directors, the persons who were Company Directors immediately before the election cease to constitute a majority of the board; or a merger, consolidation or reorganization or other change in ownership of the Company's assets or stock in which the beneficial stockholders of the Company immediately before the transaction beneficially own securities representing 50% or less of the total combined voting power or value of the Company immediately after the transaction.

#### Federal Income Tax Consequences of Option Awards and Exercises Under the 2002

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#### Plan

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The following is a general summary of the typical federal income tax consequences of the issuance and exercise of options or awards of restricted stock under the 2002 Plan. It does not describe state or other tax consequences of the issuance and exercise of options or of grant of restricted stock.

#### Options

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The grant of an ISO has no federal income tax effect on the optionee. Upon exercise the optionee does not recognize income for "regular" tax purposes. However, the excess of the fair market value of the stock subject to an option over the exercise price of such option (the "option spread") is includible in the optionee's "alternative minimum taxable income" for purposes of the alternative minimum tax. If the optionee does not dispose of the stock acquired upon exercise of an ISO until more than two years after the option grant date and more than one year after exercise of the option, any gain upon sale of the shares will be a long-term capital gain. If shares are sold or otherwise disposed of before both of these periods have expired (a "disqualifying disposition"), the option spread at the time of exercise of the option (but not more than the amount of the gain on the sale or other disposition) is ordinary income in the year of such sale or other disposition. If gain on a disqualifying disposition exceeds the amount treated as ordinary income, the excess is taxable as capital gain (which will be long-term capital gain if the shares have been held more than one year after the date of exercise of the option). The Company is not entitled to a federal income tax

deduction in connection with ISOs, except to the extent that the optionee has taxable ordinary income on a disqualifying disposition.

The grant of a NQO has no federal income tax effect on the optionee. Upon the exercise of a NQO, the optionee has taxable ordinary income (and the Company is currently entitled to a corresponding deduction) equal to the option spread on the date of exercise. Upon the disposition of stock acquired upon exercise of a NQO, the optionee recognizes either long-term or short-term capital gain or loss, depending on how long such stock was held, and based on the fair market value of the stock on date of exercise.

In the case of both ISOs and NQOs, special federal income tax rules apply if Company Common Stock is used to pay all or part of the option price. Special rules may also apply when a transferable option is transferred.

#### Stock Grants -----

Upon receipt of an award of restricted stock, a recipient generally has taxable income in the amount of the excess of the then fair market value of the Common Stock over any consideration paid for the Common Stock (the "spread"). However, if the Common Stock is subject to a "substantial risk of forfeiture" (such as a requirement that the recipient continue in the employ of the Company) and the recipient does not make an election under section 83(b) of the Internal Revenue Code, the recipient will have taxable income upon the lapse of the risk of forfeiture, rather than at receipt, in an amount equal to the spread on the date of lapse. The taxable income in the case of an employee constitutes supplemental wages subject to income and employment tax withholding, and the Company receives a corresponding income tax deduction. If the recipient makes an election under section 83(b) of the Internal Revenue Code, the stock received by the recipient is valued as of the date of receipt (without taking the restrictions into account) and the recipient has taxable income equal to any excess of that value over the amount he or she paid for the stock. The Company would again have a deduction equal to the income to the recipient. The consequences upon sale or disposition of the shares awarded or sold generally are the same as for Common Stock acquired under an NQO (see above).

#### Limitation on Deduction of Certain Compensation -----

Compensation of over \$1,000,000 paid in any year to one of the top five officers of a publicly-held corporation is not deductible for tax purposes unless the grant of the compensation meets the Internal Revenue Code's definition of "performance-based" compensation. The Company will generally attempt to ensure that any awards under the 2002 Plan meet these standards, but may not be able to do so in every instance.

The following table shows the number of shares covered by options awarded to the executive officers and the identified groups in fiscal 2001. Unless otherwise noted, each option has an exercise price equal to the fair market value of one share of Common Stock on the date of grant.

#### Executive Officers Compensation for 2001 New Plan Benefits

Name and Position -----	Number of Shares -----
Michael O'Connell President and Chief Executive Officer	25,000
John Barr, Ph.D. Vice President, Research and Development	35,000
Jayne Lange Vice President, Business Development	50,000
Gordon Sangster Chief Financial Officer	20,000
All executive officers as a group	130,000
All directors who are not executive officers as a group	175,000
All employees and consultants (other than executive officers) as a group	197,000

Stockholders are being asked to approve the adoption of the 2002 Plan. The affirmative vote of the holders of a majority of the shares of the Common Stock of the Company represented and voting at the Annual Meeting is required to adopt the 2002 Plan.

THE BOARD RECOMMENDS A VOTE "FOR" THE ADOPTION OF THE A.P. PHARMA 2002 EQUITY INCENTIVE PLAN.

The Board has selected Ernst & Young LLP ("E&Y") as independent public accountants to audit the financial statements of the Company for the fiscal year ending December 31, 2002. A representative of E&Y will be present at the Annual Meeting and will have an opportunity to make a statement if such representative desires to do so. The representative of E&Y also will be available to respond to questions raised during the meeting.

#### FINANCIAL STATEMENTS

The Company's annual report to stockholders for the fiscal year ended December 31, 2001, containing audited consolidated balance sheets as of the end of each of the past two fiscal years and audited consolidated statements of operations, shareholders' equity and cash flows for each of the last three fiscal years, is being mailed with this proxy statement to stockholders entitled to notice of the Annual Meeting.

#### SHAREHOLDER PROPOSALS FOR 2003 ANNUAL MEETING

Under the applicable rules of the Securities and Exchange Commission, a stockholder who wishes to submit a proposal for inclusion in the Proxy Statement of the Board of Directors for the annual meeting of stockholders to be held in the spring of 2003 must submit such proposal in writing to the Secretary of the Company at the Company's principal executive offices no later than December 17, 2002. The applicable rules of the SEC impose certain limitations on the content of proposals and also contain certain eligibility and other requirements (including the requirement that the proponent must have continuously held at least \$2,000 in market value or 1% of the Company's Common Stock for at least one year before the proposal is submitted).

#### OTHER MATTERS

As of the date of this Proxy Statement, the Board does not intend to bring any other business before the Annual Meeting, and so far as is known to the Board, no other matters will be presented to the Annual Meeting. If, however, any other matter is properly presented at the Annual Meeting, it is intended that proxies in the form enclosed with this Proxy Statement will be voted on such matter in accordance with the judgment of the person or persons voting such proxies, unless the proxy otherwise provides.

BY ORDER OF THE BOARD OF DIRECTORS,

Julian N. Stern, Secretary

Redwood City, California  
April 17, 2002

You Are Cordially Invited To Attend The Meeting In Person.

2002 Equity Incentive Plan  
of  
A.P. Pharma, Inc.,  
A Delaware corporation

Purpose of this Plan  
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The purpose of this 2002 Equity Incentive Plan of A.P. Pharma, Inc., a Delaware corporation (the "Company") is to enhance the long-term stockholder value of the Company by offering opportunities to eligible individuals to participate in the growth in value of the equity of the Company.

Definitions and Rules of Interpretation  
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Definitions. This Plan uses the following defined terms:

"Administrator" means the Board, the Committee, or any officer or employee of the Company to whom the Board or the Committee delegates authority to administer this Plan.

"Affiliate" means a "parent" or "subsidiary" (as each is defined in Section 424 of the Code) of the Company and any other entity that the Board or Committee designates as an "Affiliate" for purposes of this Plan.

"Applicable Law" means any and all laws of whatever jurisdiction, within or without the United States, and the rules of any stock exchange or quotation system on which Shares are listed or quoted, applicable to the taking or refraining from taking of any action under this Plan, including the administration of this Plan and the issuance or transfer of Awards or Award Shares.

"Award" means a Restricted Stock Award or Option granted in accordance with the terms of the Plan.

"Award Agreement" means the document evidencing the grant of an Award.

"Award Shares" means Shares covered by an outstanding Award or purchased under an Award.

"Board" means the board of directors of the Company.

"Change of Control" means any transaction or event that the Board specifies as a Change of Control under Section 10.4.

"Code" means the Internal Revenue Code of 1986.

"Committee" means a committee composed of Company Directors appointed in accordance with the Company's charter documents and Section 4.

"Company Director" means a member of the Board.

"Consultant" means an individual who, or an employee of any entity that, provides bona fide services to the Company or an Affiliate not in connection with the offer or sale of securities in a capital-raising transaction, but who is not an Employee.

"Director" means a member of the board of directors of the Company or an Affiliate.

"Divestiture" means any transaction or event that the Board specifies as a Divestiture under Section 10.5.

"Employee" means a regular employee of the Company or an Affiliate, including an officer or Director who is treated as an employee in the personnel records of the Company or an Affiliate, but not individuals who are classified by the Company or an Affiliate as: (i) leased from or otherwise employed by a third party, (ii) independent contractors, or (iii) intermittent or temporary workers. The Company's or an Affiliate's classification of an individual as an "Employee" (or as not an "Employee") for purposes of this Plan shall not be altered retroactively even if that classification is changed retroactively for another purpose as a result of an audit, litigation or otherwise. A Recipient shall not cease to be an Employee due to transfers between locations of the Company, or between the Company and an Affiliate, or to any successor to the Company or an Affiliate that assumes the Recipient's Options under Section 10. Neither service as a Director nor receipt of a director's fee shall be sufficient to make a Director an "Employee".

"Exchange Act" means the Securities Exchange Act of 1934.

"Executive" means an individual who is subject to Section 16 of the Exchange Act or who is a "covered employee" under Section 162(m) of the Code, in either case because of the individual's relationship with the Company or an Affiliate.

"Expiration Date" means, with respect to an Award, the date stated in the Award Agreement as the expiration date of the Award or, if no such date is stated in the Award Agreement, then the last day of the maximum exercise period for the Award, disregarding the effect of a Recipient's Termination or any other event that would shorten that period.

"Fair Market Value" means the value of Shares as determined under Section 17.2.

"Fundamental Transaction" means any transaction or event described in Section 10.3.

"Grant Date" means the date the Administrator approves the grant of an Award. However, if the Administrator specifies that an Award's Grant Date is a future date or the date on which a condition is satisfied, the Grant Date for such Award is that future date or the date that the condition is satisfied.

"Incentive Stock Option" means an Option intended to qualify as an incentive stock option under Section 422 of the Code and designated as an Incentive Stock Option in the Award Agreement for that Option.

"Listed Security" means any Share listed or approved for listing upon notice of issuance on a national securities exchange or other market system that meets the requirements of Section 25100(o) of the California Securities Law of 1968, as amended.

"Nonstatutory Option" means any Option other than an Incentive Stock Option.

"Objectively Determinable Performance Condition" shall mean a performance condition (i) that is established (x) at the time an Award is granted or (y) no later than the earlier of (1) 90 days after the beginning of the period of service to which it relates, or (2) before the elapse of 25% of the period of service to which it relates, (ii) that is uncertain of achievement at the time it is established, and (iii) the achievement of which is determinable by a third party with knowledge of the relevant facts. Examples of measures that may be used in Objectively Determinable Performance Conditions include net order dollars, net profit dollars, net profit growth, net revenue dollars, revenue growth, individual performance, earnings per share, return on assets, return on equity, and other financial objectives, objective customer satisfaction indicators and efficiency measures, each with respect to the Company and/or an individual business unit.

"Officer" means an officer of the Company as defined in Rule 16a-1 adopted under the Exchange Act.

"Option" means a right to purchase Shares of the Company granted under this Plan.

"Option Price" means the price payable under an Option for Shares, not including any amount payable in respect of withholding or other taxes.

"Option Shares" means Shares covered by an outstanding Option or purchased under an Option.

"Plan" means this 2002 Equity Incentive Plan of A.P. Pharma, Inc.

"Purchase Price" means the price payable under a Restricted Stock Award for Shares, not including any amount payable in respect of withholding or other taxes.

"Qualified Domestic Relations Order" means a judgment, order, or decree meeting the requirements of Section 414(p) of the Code.

"Recipient" means: (i) a person to whom an Award has been granted, including a holder of a Substitute Award, (ii) a person to whom an Award has been transferred in accordance with all applicable requirements of Sections 6.5, 7(h) and 16, and (iii) a person who holds Option Shares subject to any right of repurchase under Section 15.2.

"Restricted Stock Award" means an offer by the Company to sell shares subject to certain restrictions pursuant to the Award Agreement as

described in Section 8.

"Reverse Vesting" means, with respect to an Option, that an Option is or was fully exercisable but that, subject to a "reverse" vesting schedule, the Company has a right to repurchase the Option Shares as specified in Section 15.2(a), with the Company's right of repurchase expiring in accordance with the "forward" vesting schedule that would otherwise have applied to the Option under which the Option Shares were purchased or other vesting schedule described in the Award Agreement. With respect to a Restricted Stock Award, Reverse Vesting means that the Company has a right to repurchase the Award Shares purchased pursuant to the Restricted Stock Award, as specified in Section 15.2(a), with the Company's right of repurchase expiring in accordance with the vesting schedule in the Award Agreement.

"Rule 16b-3" means Rule 16b-3 adopted under Section 16(b) of the Exchange Act.

"Securities Act" means the Securities Act of 1933.

"Share" means a share of the common stock of the Company or other securities substituted for the common stock under Section 10.

"Substitute Option" means an Option granted in substitution for, or upon the conversion of, an option granted by another entity to purchase equity securities in the granting entity.

"Substitute Restricted Stock Award" means a Restricted Stock Award granted in substitution for, or upon the conversion of, a stock award granted by another entity to purchase equity securities in the granting entity.

"Ten Percent Stockholder" means any person who, directly or by attribution under Section 424(d) of the Code, owns stock possessing more than ten percent of the total combined voting power of all classes of stock of the Company or of any Affiliate on the Grant Date.

"Termination" means that the Recipient has ceased to be, with or without any cause or reason, an Employee, Director or Consultant. However, unless so determined by the Administrator, "Termination" shall not include a change in status from an Employee, Consultant or Director to another such status. An event that causes an Affiliate to cease being an Affiliate shall be treated as the "Termination" of that Affiliate's Employees, Directors, and Consultants.

Rules of Interpretation. Any reference to a "Section", without more, is to a Section of this Plan. Captions and titles are used for convenience in this Plan and shall not, by themselves, determine the meaning of this Plan. Except when otherwise indicated by the context, the singular includes the plural and vice versa. Any reference to a statute is also a reference to the applicable rules and regulations adopted under that statute. Any reference to a statute, rule or regulation, or to a section of a statute, rule or regulation, is a reference to that statute, rule, regulation, or section as amended from time to time, both before and after the effective date of this Plan and including any successor provisions.

Shares Subject to this Plan; Term of this Plan

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Number of Award Shares. Subject to adjustment under Section 10, the maximum number of Shares that may be issued under this Plan is 500,000.

Source of Shares. Award Shares may be authorized but unissued Shares or treasury Shares. If an Award is terminated, expires, or otherwise becomes unexercisable without having been exercised in full, the unpurchased Shares that were subject to the Award shall revert to this Plan and shall again be available for future issuance under this Plan. Shares actually issued under this Plan shall not be available for regrant even if repurchased by the Company.

Term of this Plan

This Plan shall be effective on the date it is approved by the Board. However, no Award may be exercised unless and until the Company's stockholders approve this Plan within 12 months after the Board approves this Plan.

Subject to Section 13, this Plan shall continue in effect for a period of ten years from the earlier of the date on which the Plan was adopted by the Board and the date on which the Plan was approved by the Company's stockholders.



General

The Board shall have ultimate responsibility for administering this Plan. The Board may delegate certain of its responsibilities to a Committee, which shall consist of at least two members of the Board. The Board or the Committee may further delegate its responsibilities to any Employee of the Company or any Affiliate. Where this Plan specifies that an action is to be taken or a determination made by the Board, only the Board may take that action or make that determination. Where this Plan specifies that an action is to be taken or a determination made by the Committee, only the Committee may take that action or make that determination. Where this Plan references the "Administrator", the action may be taken or determination made by the Board, the Committee, or other Administrator. However, only the Board or the Committee may approve grants of Awards to Executives, and an Administrator other than the Board or the Committee may grant Awards only within guidelines established by the Board or Committee. Moreover, all actions and determinations by any Administrator are subject to the provisions of this Plan.

So long as the Company has registered and outstanding a class of equity securities under Section 12 of the Exchange Act, the Committee shall consist of Company Directors who are "Non-Employee Directors" as defined in Rule 16b-3 and, after the expiration of any transition period permitted by Treasury Regulations Section 1.162-27(h)(3), who are "outside directors" as defined in Section 162(m) of the Code.

Authority of Administrator. Subject to the other provisions of this Plan, the Administrator shall have the authority:

- to grant Awards, including Substitute Awards;
- to determine the Fair Market Value of Shares;
- to determine the Option Price and the Purchase Price under Awards;
- to select the Recipients;
- to determine the times Awards are granted;
- to determine the number of Shares subject to each Award;
- to determine the types of payment that may be used to purchase Award Shares;
- to determine the types of payment that may be used to satisfy withholding tax obligations;
- to determine the other terms of each Award, including but not limited to the time or times at which Awards may be exercised, whether and under what conditions an Award is assignable, and whether an Option is a Nonstatutory Option or an Incentive Stock Option;
- to modify or amend any Award;
- to authorize any person to sign any Award Agreement or other document related to this Plan on behalf of the Company;
- to determine the form of any Award Agreement or other document related to this Plan, and whether that document, including signatures, may be in electronic form;
- to interpret this Plan and any Award Agreement or document related to this Plan;
- to correct any defect, remedy any omission, or reconcile any inconsistency in this Plan, any Award Agreement or any other document related to this Plan;
- to adopt, amend, and revoke rules and regulations under this Plan, including rules and regulations relating to sub-plans and Plan addenda;
- to adopt, amend, and revoke rules and procedures relating to the operation and administration of this Plan to accommodate non-U.S. Recipients and the requirements of Applicable Law such as: (i) rules and procedures regarding the conversion of local currency, withholding

procedures and the handling of stock certificates to comply with local practice and requirements, and (ii) sub-plans and Plan addenda for non-U.S. Recipients; and

to make all other determinations the Administrator deems necessary or advisable for the administration of this Plan.

Scope of Discretion. Subject to the specific provisions and specific limitations of this Plan, as well as all rights conferred on specific Recipients by Award Agreements and other agreements, (i) on all matters for which this Plan confers the authority, right or power on the Board, the Committee, or other Administrator to make decisions, that body may make those decisions in its sole and absolute discretion and (ii) in making those decisions, the Board, Committee or other Administrator need not treat all persons eligible to receive Awards, all Recipients, all Awards or all Award Shares the same way.

#### Persons Eligible to Receive Awards

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Eligible Individuals. Awards (including Substitute Awards) may be granted to, and only to, Employees, Directors and Consultants, including prospective Employees, Directors and Consultants conditioned on the beginning of their service for the Company or an Affiliate.

#### Section 162(m) Limitation.

Options. So long as the Company is a "publicly held corporation" within the meaning of Section 162(m) of the Code: (a) no Employee or prospective Employee may be granted one or more Options within any fiscal year of the Company to purchase more than 250,000 Shares under Options, subject to adjustment under Section 10, and (b) Options may be granted to an Executive only by the Committee (and, notwithstanding Section 4.1(a), not by the Board). If an Option is cancelled without being exercised or if the Option Price of an Option is reduced, that cancelled or repriced Option shall continue to be counted against the limit on Shares under this Section 5.2.

Restricted Stock Awards. Any Restricted Stock Award intended as "qualified performance-based compensation" within the meaning of Section 162(m) of the Code must vest or become exercisable contingent on the achievement of one or more Objectively Determinable Performance Conditions, the Restricted Stock Award may be granted only by the Committee, and the material terms of the Award, including the maximum amount of the Award and the Award formula, must be approved by the stockholders of the Company before the Award Shares under such Restricted Stock Award are issued.

#### Terms and Conditions of Options

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The following rules apply to all Options:

Price. No Option intended as "qualified incentive-based compensation" within the meaning of Section 162(m) of the Code may have an Option Price less than 100% of the Fair Market Value of the Shares on the Grant Date. In no event will the Option Price of any Option be less than the par value of the Shares issuable under the Option if that is required by Applicable Law.

Term. No Option shall be exercisable after its Expiration Date. No Option may have an Expiration Date that is more than ten years after its Grant Date.

Vesting. Options shall be exercisable: (a) on the Grant Date, or (b) in accordance with a schedule related to the Grant Date, the date the Recipient's directorship, employment or consultancy begins, or a different date specified in the Option Agreement. If so provided in the Option Agreement, an Option may be exercisable subject to the application of Reverse Vesting to the Option Shares.

#### Form of Payment.

The Administrator shall determine the acceptable form and method of payment for exercising an Option.

Acceptable forms of payment for all Option Shares are cash, check or wire transfer, denominated in U.S. dollars except as specified by the Administrator for non-U.S. Employees or non-U.S. sub-plans.

In addition, the Administrator may permit payment to be made by any of the following methods:

other Shares, or the designation of other Shares, which (A) in the case of Shares acquired upon exercise of an option (whether or not under this Plan) have been owned by the Recipient for more than six months on the date of surrender, and (B) have a Fair Market Value on the date of surrender equal to the Option Price of the Shares as to which the Option is being exercised;

provided that a public market exists for the Shares, through a "same day sale" commitment from the Recipient and a broker-dealer that is a member of the National Association of Securities Dealers (an "NASD Dealer") under which the Recipient irrevocably instructs the NASD Dealer promptly to forward an amount equal to the Option Price directly to the Company (a "Cashless Exercise").

one or more full recourse promissory notes bearing interest at a fair market value rate that is at least sufficient to avoid imputation of interest under Sections 483, 1274 and 7872 of the Code and with such other terms as the Administrator specifies, except that Consultants may not purchase Shares with a promissory note unless the note is adequately secured by collateral other than the Shares, the portion of the Option Price equal to the par value of the Shares must be paid in cash or other lawful consideration, other than the note, if that is required by Applicable Law, and the Company shall at all times comply with any applicable margin rules of the Federal Reserve; and

any combination of the methods of payment permitted by any paragraph of this Section 6.4.

Nonassignability of Options. Except as set forth in any Option Agreement, no Option shall be assignable or otherwise transferable by the Recipient except by will or by the laws of descent and distribution. However, Options may be transferred and exercised in accordance with a Qualified Domestic Relations Order.

Substitute Options. The Board may cause the Company to grant Substitute Options in connection with the acquisition by the Company or an Affiliate of equity securities of any entity (including by merger) or all or a portion of the assets of any entity. Any such substitution shall be effective when the acquisition closes. Substitute Options may be Nonstatutory Options or Incentive Stock Options. Unless and to the extent specified otherwise by the Board, Substitute Options shall have the same terms and conditions as the options they replace, except that (subject to Section 10) Substitute Options shall be Options to purchase Shares rather than equity securities of the granting entity and shall have an Option Price that, as determined by the Board in its sole and absolute discretion, properly reflects the substitution.

#### Incentive Stock Options - - - - -

The following rules apply only to Incentive Stock Options and only to the extent these rules are more restrictive than the rules that would otherwise apply under this Plan. With the consent of the Recipient, or where this Plan provides that an action may be taken notwithstanding any other provision of this Plan, the Administrator may deviate from the requirements of this Section, notwithstanding that any Incentive Stock Option modified by the Administrator will thereafter be treated as a Nonstatutory Option.

The Expiration Date of an Incentive Stock Option shall not be later than ten years from its Grant Date, with the result that no Incentive Stock Option may be exercised after the expiration of ten years from its Grant Date.

No Incentive Stock Option may be granted more than ten years from the date this Plan was approved by the Board.

Options intended to be incentive stock options under Section 422 of the Code that are granted to any single Recipient under all incentive stock option plans of the Company and its Affiliates, including incentive stock options granted under this Plan, may not vest at a rate of more than \$100,000 in Fair Market Value of stock (measured on the grant dates of the options) during any calendar year. For this purpose, an option vests with respect to a given share of stock the first time its holder may purchase that share, notwithstanding any right of the Company to repurchase that share. Unless the Administrator specifies otherwise in the related agreement governing the option, this vesting limitation shall be applied by, to the extent necessary to satisfy this \$100,000 rule, treating certain stock options that were intended to be incentive stock options under Section 422 of the Code as Nonstatutory Options. The stock options or portions of stock options to be reclassified as Nonstatutory Options are

those with the highest option prices, whether granted under this Plan or any other equity compensation plan of the Company or any Affiliate that permits that treatment. This Section 7(c) shall not cause an Incentive Stock Option to vest before its original vesting date or cause an Incentive Stock Option that has already vested to cease to be vested.

In order for an Incentive Stock Option to be exercised for any form of payment other than those described in Section 6.4(b), that right must be stated in the Option Agreement relating to that Incentive Stock Option. Any Incentive Stock Option granted to a Ten Percent Stockholder, must have an Expiration Date that is not later than five years from its Grant Date, with the result that no such Option may be exercised after the expiration of five years from the Grant Date.

The Option Price of an Incentive Stock Option shall never be less than the Fair Market Value of the Shares at the Grant Date. The Option Price for the Shares covered by an Incentive Stock Option granted to a Ten Percent Stockholder shall never be less than 110% of the Fair Market Value of the Shares at the Grant Date.

Incentive Stock Options may be granted only to Employees. If a Recipient changes status from an Employee to a Consultant, that Recipient's Incentive Stock Options become Nonstatutory Options if not exercised within the time period described in Section 7(i).

No rights under an Incentive Stock Option may be transferred by the Recipient, other than by will or the laws of descent and distribution. During the life of the Recipient, an Incentive Stock Option may be exercised only by the Recipient. The Company's compliance with a Qualified Domestic Relations Order, or the exercise of an Incentive Stock Option by a guardian or conservator appointed to act for the Recipient, shall not violate this Section 7(h).

An Incentive Stock Option shall be treated as a Nonstatutory Option if it remains exercisable after, but is not exercised within, the three-month period beginning with the Recipient's Termination for any reason other than the Recipient's death or disability (as defined in Section 22(c) of the Code). In the case of Termination due to death or disability, an Incentive Stock Option shall be treated as a Nonstatutory Option if it remains exercisable after, but is not exercised within, one year after the Recipient's Termination.

#### Restricted Stock Awards - - - - -

The following rules apply to all Restricted Stock Awards:

**Price; Payment.** The Purchase Price for the Award Shares issuable under a Restricted Stock Award shall be determined by the Administrator; provided that in no event shall such Purchase Price be less than the par value of the Award Shares issuable under the Restricted Stock Award.

**Term.** No Restricted Stock Award shall be exercisable after its Expiration Date. No Restricted Stock Award may have an Expiration Date that is more than ten years after its Grant Date.

**Vesting.** Restricted Stock Awards shall be exercisable: (a) on the Grant Date, or (b) in accordance with a schedule related to the Grant Date, the date the Recipient's directorship, employment or consultancy begins, or a different date specified in the Award Agreement.

**Restriction Period.** Subject to this Plan and the Award Agreement, during a period set by the Administrator, commencing with the Grant Date of the Restricted Stock Award and ending not less than three (3) years and not more than ten (10) years from such Grant Date, the Recipient shall not be permitted to sell, assign, transfer, pledge or otherwise encumber the Award Shares of a Restricted Stock Award. Within these limits, the Administrator may provide for the lapse of such restrictions in installments, but, subject to Sections 10.3 and 10.4, may not accelerate or waive such restrictions.

**Right of Repurchase.** If so provided in the Award Agreement, Award Shares acquired pursuant to a Restricted Stock Award may be subject to Reverse Vesting.

**Form of Payment.** The Administrator shall determine the acceptable form and method of payment for exercising a Restricted Stock Award.

Acceptable forms of payment for all Award Shares are cash, check or wire transfer, denominated in U.S. dollars except as specified by the Administrator for non-U.S. Employees or non-U.S. sub-plans.

In addition, the Administrator may permit payment to be made by any of the methods permitted with respect to the exercise of Options pursuant to Section 6.4.

**Nonassignability of Restricted Stock Awards.** Except as set forth in any Award Agreement, no Restricted Stock Award shall be assignable or otherwise transferable by the Recipient except by will or by the laws of descent and distribution. However, Restricted Stock Awards may be transferred and exercised in accordance with a Qualified Domestic Relations Order.

**Substitute Restricted Stock Award.** The Board may cause the Company to grant Substitute Restricted Stock Awards in connection with the acquisition by the Company or an Affiliate of equity securities of any entity (including by merger) or all or a portion of the assets of any entity. Unless and to the extent specified otherwise by the Board, Substitute Restricted Stock Awards shall have the same terms and conditions as the options they replace, except that (subject to Section 10) Substitute Restricted Stock Awards shall be Restricted Stock Awards to purchase Shares rather than equity securities of the granting entity and shall have a Purchase Price that, as determined by the Board in its sole and absolute discretion, properly reflects the substitution.

#### Exercise of Awards - - - - -

**In General.** An Award shall be exercisable in accordance with this Plan, the Award Agreement under which it is granted, and as prescribed by the Administrator.

**Time of Exercise.** Options and Restricted Stock Awards shall be considered exercised when the Company receives: (a) written notice of exercise from the person entitled to exercise the Option or Restricted Stock Award, (b) full payment, or provision for payment, in a form and method approved by the Administrator, for the Shares for which the Option or Restricted Stock Award is being exercised, and (c) with respect to Nonstatutory Options, payment, or provision for payment, in a form approved by the Administrator, of all applicable withholding taxes due upon exercise. An Award may not be exercised for a fraction of a Share.

**Issuance of Award Shares.** The Company shall issue Award Shares in the name of the person properly exercising the Award. If the Recipient is that person and so requests, the Award Shares shall be issued in the name of the Recipient and the Recipient's spouse. The Company shall endeavor to issue Award Shares promptly after an Award is exercised. However, until Award Shares are actually issued, as evidenced by the appropriate entry on the stock books of the Company or its transfer agent, no right to vote or receive dividends or other distributions, and no other rights as a stockholder, shall exist with respect to the Award Shares, even though the Recipient has completed all the steps necessary to exercise the Award. No adjustment shall be made for any dividend, distribution, or other right for which the record date precedes the date the Award Shares are issued, except as provided in Section 10.

#### Termination

**In General.** Except as provided by the Administrator, including in an Award Agreement, and as otherwise provided in Sections 9.4(b), (c), (d), (e), (f) and (g), after a Recipient's Termination, the Recipient's Awards shall be exercisable to the extent (but only to the extent) they are vested on the date of that Termination and only during the period ending three months after the Termination, but in no event after the Expiration Date. To the extent the Recipient does not exercise an Award within the time specified for exercise, the Award shall automatically terminate. With respect to Restricted Stock Awards, except to the extent otherwise provided by the Administrator, including in the Award Agreement and in accordance with Section 10, upon termination of a Recipient's employment for any reason during the restriction period provided for in Section 8(d), all Award Shares of a Restricted Stock Award still subject to such restriction period shall be forfeited by the Recipient and to the extent previously purchased by the Recipient shall be repurchased by the Company for an amount equal to the original Purchase Price.

**Leaves of Absence.** Unless otherwise provided in the Award Agreement, no Award may be exercised more than three months after the beginning of a leave of absence, other than a personal or medical leave approved by the Administrator with employment guaranteed upon return. Awards shall not continue to vest during a leave of absence, other than an approved personal or medical leave with employment guaranteed upon return.

**Death or Disability.** Unless otherwise provided in the Award Agreement,

if a Recipient's Termination is due to death or disability (as determined by the Administrator with respect to all Awards other than Incentive Stock Options and as defined by Section 22(e) of the Code with respect to Incentive Stock Options), all Awards of that Recipient to the extent exercisable at the date of that Termination may be exercised for one year after that Termination, but in no event after the Expiration Date. In the case of Termination due to death, an Award may be exercised as provided in Section 16. In the case of Termination due to disability, if a guardian or conservator has been appointed to act for the Recipient and been granted this authority as part of that appointment, that guardian or conservator may exercise the Award on behalf of the Recipient. In the case of a Recipient who dies or become disabled within three months after Termination, if the Termination was not due to Cause, the Recipient's Awards may be exercised for one year after that Termination. To the extent an Award is not so exercised within the time specified for its exercise, the Award shall automatically terminate.

**Divestiture.** If a Recipient's Termination is due to a Divestiture, the Board may take any one or more of the actions described in Section 10.3 or 10.4.

**Retirement.** Unless otherwise provided in the Award Agreement by the Administrator, if a Recipient's Termination is due to the Recipient's retirement in accordance with the Company's or an Affiliate's retirement policy, all Awards of that Recipient to the extent exercisable at the Recipient's date of retirement may be exercised for one year after the Recipient's date of retirement, but in no event after the Expiration Date. To the extent the Recipient does not exercise an Option within the time specified for exercise, the Award shall automatically terminate.

**Severance Programs.** Unless otherwise provided in the Award Agreement by the Administrator, if a Recipient's Termination results from participation in a voluntary severance incentive program of the Company or an Affiliate approved by the Board, all Awards of that Employee to the extent exercisable at the time of that Termination shall be exercisable for one year after the Recipient's Termination, but in no event after the Expiration Date. If the Recipient does not exercise an Award within the time specified for exercise, the Award shall automatically terminate.

**Termination for Cause.** If a Recipient's Termination is due to cause, all of the Recipient's Awards shall automatically terminate and cease to be exercisable at the time of Termination and all Awards exercised after the first event constituting cause may be rescinded by the Administrator. "Cause" means dishonesty, fraud, misconduct, disclosure or misuse of confidential information, conviction of, or a plea of guilty or no contest to, a felony or similar offense, habitual absence from work for reasons other than illness, or intentional conduct that could cause significant injury to the Company or an Affiliate, in each case as determined by the Administrator.

**Reverse Vesting.** Under any circumstances stated in this Section 9.4 in which all unvested Options of a Recipient immediately vest, the Company's repurchase rights shall lapse on all Option Shares held by that Recipient that are subject to Reverse Vesting.

**Consulting or Employment Relationship.** Nothing in this Plan or in any Award Agreement, and no Award or the fact that Award Shares remain subject to repurchase rights, shall: (a) interfere with or limit the right of the Company or any Affiliate to terminate the employment or consultancy of any Recipient at any time, whether with or without cause or reason, and with or without the payment of severance or any other compensation or payment, or (b) interfere with the application of any provision in any of the Company's or any Affiliate's charter documents or Applicable Law relating to the election, appointment, term of office, or removal of a Director.

#### Certain Transactions and Events -----

**In General.** Except as specifically provided in this Section 10, no change in the capital structure of the Company, merger, sale or other disposition of assets or a subsidiary, change of control, issuance by the Company of shares of any class of securities convertible into shares of any class, conversion of securities, or other transaction or event shall require or be the occasion for any adjustments of the type described in this Section 10.

**Changes in Capital Structure.** In the event of any stock split, reverse stock split, recapitalization, combination or reclassification of stock, stock dividend, spin-off, or similar change to the capital structure of the Company (not including a Fundamental Transaction or Change of Control), the Board shall make whatever adjustments it concludes are appropriate to: (a)

the number and type of Awards that may be granted under this Plan, (b) the number and type of Options that may be granted to any individual under this Plan, (c) the Purchase Price of any Restricted Stock Award, (d) the Option Price and number and class of securities issuable under each outstanding Option, and (e) the repurchase price of any securities substituted for Option Shares that are subject to repurchase rights. The specific adjustments shall be determined by the Board in its sole and absolute discretion. Unless the Board specifies otherwise, any securities issuable as a result of any such adjustment shall be rounded to the next lower whole security.

**Fundamental Transactions.** If the Company merges with another entity in a transaction in which the Company is not the surviving entity or if, as a result of any other transaction or event, other securities are substituted for the Shares or Shares may no longer be issued (each a "Fundamental Transaction"), then, notwithstanding any other provision of this Plan, the Board shall do one or more of the following contingent on the closing or completion of the Fundamental Transaction: (a) arrange for the substitution of options or other compensatory awards on equity securities other than Shares (including, if appropriate, equity securities of an entity other than the Company) in exchange for Awards, (b) accelerate the vesting and termination of outstanding Awards, in whole or in part, so that Awards can be exercised before or otherwise in connection with the closing or completion of the transaction or event but then terminate, (c) cancel Awards in exchange for cash payments to Recipients, (d) either arrange for any repurchase rights of the Company with respect to Award Shares to apply to the securities issued in substitution for Shares or terminate repurchase rights on Award Shares. The Board need not adopt the same rules for each Award or each Recipient.

**Changes of Control.** The Board may also, but need not, specify that other transactions or events constitute a "Change of Control". The Board may do that either before or after the transaction or event occurs. Examples of transactions or events that the Board may treat as Changes of Control are: (a) the Company or an Affiliate is a party to a merger, consolidation, amalgamation, or other transaction in which the beneficial stockholders of the Company, immediately before the transaction, beneficially own securities representing 50% or less of the total combined voting power or value of the Company immediately after the transaction, (b) any person or entity, including a "group" as contemplated by Section 13(d)(3) of the Exchange Act, acquires securities holding 30% or more of the total combined voting power or value of the Company, or (c) as a result of or in connection with a contested election of Company Directors, the persons who were Company Directors immediately before the election cease to constitute a majority of the Board. In connection with a Change of Control, notwithstanding any other provision of this Plan, the Board may take any one or more of the actions described in Section 10.3. In addition, the Board may extend the date for the exercise of Awards (but not beyond their original Expiration Date). The Board need not adopt the same rules for each Award or each Recipient.

**Divestiture.** If the Company or an Affiliate sells or otherwise transfers equity securities of an Affiliate to a person or entity other than the Company or an Affiliate, or leases, exchanges or transfers all or any portion of its assets to such a person or entity, then the Board, in its sole and absolute discretion, may specify that such transaction or event constitutes a "Divestiture". In connection with a Divestiture, notwithstanding any other provision of this Plan, the Board may take one or more of the actions described in Section 10.3 or 10.4 with respect to Awards or Award Shares held by, for example, Employees, Directors or Consultants for whom that transaction or event results in a Termination. The Board need not adopt the same rules for each Award or each Recipient.

**Dissolution.** If the Company adopts a plan of dissolution, the Board may, in its sole and absolute discretion, cause Awards to be fully vested and exercisable (but not after their Expiration Date) before the dissolution is completed but contingent on its completion and may cause the Company's repurchase rights on Award Shares to lapse upon completion of the dissolution. To the extent not exercised before the earlier of the completion of the dissolution or their Expiration Date, Awards shall terminate just before the dissolution is completed. The Board need not adopt the same rules for each Award or each Recipient.

**Cut-Back to Preserve Benefits.** If the Administrator determines that the net after-tax amount to be realized by any Recipient, taking into account any accelerated vesting, termination of repurchase rights, or cash payments to that Recipient in connection with any transaction or event addressed in this Section 10 would be greater if one or more of those steps were not taken with respect to that Recipient's Awards or Award Shares, then and to the extent determined by the Administrator, one or more of those steps shall not be taken.

## Withholding and Tax Reporting

### Tax Withholding Alternatives

**General.** Whenever Award Shares are issued or become free of restrictions, the Company may require the Recipient to remit to the Company an amount sufficient to satisfy any applicable tax withholding requirement, whether the related tax is imposed on the Recipient or the Company. The Company shall have no obligation to deliver Award Shares or release Award Shares from an escrow until the Recipient has satisfied those tax withholding obligations. Whenever payment in satisfaction of Awards is made in cash, the payment will be reduced by an amount sufficient to satisfy all tax withholding requirements.

**Method of Payment.** The Recipient shall pay any required withholding using the forms of consideration described in Section 6.4(b), except that, in the discretion of the Administrator, the Company may also permit the Recipient to use any of the forms of payment described in Section 6.4(c). The Administrator may also permit Award Shares to be withheld to pay required withholding. If the Administrator permits Award Shares to be withheld, the Fair Market Value of the Award Shares withheld shall not exceed the amount determined by the applicable minimum statutory withholding rates, and shall be determined as of the date that the amount of tax to be withheld or tendered for this purpose is to be determined.

**Reporting of Dispositions.** Any holder of Option Shares acquired under an Incentive Stock Option shall promptly notify the Administrator in writing of the sale or other disposition of any of those Option Shares if the disposition occurs during: (a) the longer of two years after the Grant Date of the Incentive Stock Option and one year after the date the Incentive Stock Option was exercised, or (b) such other period as the Administrator has established.

### Compliance with Law

**Applicable Law.** The grant of Awards and the issuance and subsequent transfer of Award Shares shall be subject to compliance with all Applicable Law, including all applicable securities laws. Awards may not be exercised, and Award Shares may not be transferred, in violation of Applicable Law. Thus, for example, Awards may not be exercised unless: (a) a registration statement under the Securities Act is then in effect with respect to the related Award Shares, or (b) in the opinion of legal counsel to the Company, those Award Shares may be issued in accordance with an applicable exemption from the registration requirements of the Securities Act and any other applicable securities laws. The failure or inability of the Company to obtain from any regulatory body the authority considered by the Company's legal counsel to be necessary or useful for the lawful issuance of any Award Shares or their subsequent transfer shall relieve the Company of any liability for failing to issue those Award Shares or permitting their transfer. As a condition to the exercise of any Award or the transfer of any Award Shares, the Company may require the Recipient to satisfy any requirements or qualifications that may be necessary or appropriate to comply with or evidence compliance with any Applicable Law.

### Amendment or Termination of this Plan or Outstanding Awards

**Amendment and Termination.** The Board may at any time amend, suspend, or terminate this Plan.

**Stockholder Approval.** The Company shall obtain the approval of the Company's stockholders for any amendment to this Plan if stockholder approval is necessary or desirable to comply with any Applicable Law or with the requirements applicable to the grant of Awards intended to be Incentive Stock Options. The Board may also, but need not, require that the Company's stockholders approve any other amendments to this Plan.

**Effect.** No amendment, suspension, or termination of this Plan, and no modification of any Award even in the absence of an amendment, suspension, or termination of this Plan, shall impair any existing contractual rights of any Recipient unless the affected Recipient consents to the amendment, suspension, termination, or modification. However, no such consent shall be required if the Administrator determines, in its sole and absolute discretion, that the amendment, suspension, termination, or modification: (a) is required or advisable in order for the Company, the Plan or the Award to satisfy Applicable Law or to meet the requirements of any accounting standard; or (b) in connection with any transaction or event



described in Section 10, is in the best interests of the Company or its stockholders. The Administrator may, but need not, take the tax consequences to affected Recipients into consideration in acting under the preceding sentence. Termination of this Plan shall not affect the Administrator's ability to exercise the powers granted to it under this Plan with respect to Awards granted before the termination, or Award Shares issued under such Awards, even if those Award Shares are issued after the termination.

#### Reserved Rights

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Nonexclusivity of this Plan. This Plan shall not limit the power of the Company or any Affiliate to adopt other incentive arrangements including, for example, the grant or issuance of stock options, stock, or other equity-based rights under other plans or independently of any plan.

Unfunded Plan. This Plan shall be unfunded. Although bookkeeping accounts may be established with respect to Recipients, any such accounts will be used merely as a convenience. The Company shall not be required to segregate any assets on account of this Plan, the grant of Awards, or the issuance of Award Shares. The Company and the Administrator shall not be deemed to be a trustee of stock or cash to be awarded under this Plan. Any obligations of the Company to any Recipient shall be based solely upon contracts entered into under this Plan, such as Award Agreements. No such obligation shall be deemed to be secured by any pledge or other encumbrance on any assets of the Company. Neither the Company nor the Administrator shall be required to give any security or bond for the performance of any such obligation.

#### Special Arrangements Regarding Award Shares

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Escrows and Pledges. To enforce any restrictions on Award Shares including restrictions related to Reverse Vesting, the Administrator may require their holder to deposit the certificates representing Award Shares, with stock powers or other transfer instruments approved by the Administrator endorsed in blank, with the Company or an agent of the Company to hold in escrow until the restrictions have lapsed or terminated. The Administrator may also cause a legend or legends referencing the restrictions to be placed on the certificates. Any Recipient who delivers a promissory note as partial or full consideration for the purchase of Award Shares will be required to pledge and deposit, with the Company, some or all of the Award Shares as collateral to secure the payment of the note. However, the Administrator may require or accept other or additional forms of collateral to secure the note and, in any event, the Company will have full recourse against the maker of the note, notwithstanding any pledge or other collateral, unless stated otherwise in the Award Agreement and the note.

#### Repurchase Rights

Reverse Vesting. If an Option or Restricted Stock Award is subject to Reverse Vesting, the Company shall have the right, during the seven months after the Recipient's Termination, to repurchase any or all of the Award Shares that were unvested as of the date of that Termination, for a price equal to the lower of: (i) the Option Price or Purchase Price for such Shares, minus the amount of any cash dividends paid or payable with respect to the Award Shares for which the record date precedes the repurchase, and (ii) the Fair Market Value of those Option Shares as of the date of the Termination. The repurchase price shall be paid in cash or, if the Option Shares were purchased in whole or in part for a promissory note, cancellation of indebtedness under that note, or a combination of those means. The Company may assign this right of repurchase.

Procedure. The Company or its assignee may choose to give the Recipient a written notice of exercise of its repurchase rights under this Section 15.2. However, the Company's failure to give such a notice shall not affect its rights to repurchase Award Shares. The Company must, however, tender the repurchase price during the period specified in this Section 15.2 for exercising its repurchase rights in order to exercise such rights.

Market Standoff. If requested by the Company or a representative of its underwriters in connection with a public offering of any securities of the Company registered under the Securities Act, Recipients or certain Recipients shall be prohibited from selling some or all of their Award Shares during a period not to exceed 180 days after the effective date of any registration statement of the Company.

Dividends. Dividends on Award Shares that are subject to any

restrictions, including Reverse Vesting, shall be subject to the same restriction, including those set forth in this Section 15, as the Award Shares on which the dividends were paid.

Beneficiaries

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A Recipient may file a written designation of one or more beneficiaries who are to receive the Recipient's rights under the Recipient's Awards after the Recipient's death. A Recipient may change such a designation at any time by written notice. If a Recipient designates a beneficiary, the beneficiary may exercise the Recipient's Awards after the Recipient's death. If a Recipient dies when the Recipient has no living beneficiary designated under this Plan, the Company shall allow the executor or administrator of the Recipient's estate to exercise the Award or, if there is none, the person entitled to exercise the Option under the Recipient's will or the laws of descent and distribution. In any case, no Award may be exercised after its Expiration Date.

Miscellaneous

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Governing Law. This Plan and all determinations made and actions taken under this Plan shall be governed by the substantive laws, but not the choice of law rules, of the State of Delaware.

Determination of Value. Fair Market Value shall be determined as follows:

Listed Stock. If the Shares are traded on any established stock exchange or quoted on a national market system, Fair Market Value shall be the closing sales price for the Shares as quoted on that stock exchange or system for the date the value is to be determined (the "Value Date") as reported in The Wall Street Journal or a similar publication. If no sales are reported as having occurred on the Value Date, Fair Market Value shall be that closing sales price for the last preceding trading day on which sales of Shares are reported as having occurred. If no sales are reported as having occurred during the five trading days before the Value Date, Fair Market Value shall be the closing bid for Shares on the Value Date. If Shares are listed on multiple exchanges or systems, Fair Market Value shall be based on sales or bids on the primary exchange or system on which Shares are traded or quoted.

Reservation of Shares. During the term of this Plan, the Company will at all times reserve and keep available such number of Shares as are still issuable under this Plan.

Electronic Communications. Any Award Agreement, notice of exercise of an Award, or other document required or permitted by this Plan may be delivered in writing or, to the extent determined by the Administrator, electronically. Signatures may also be electronic if permitted by the Administrator.

Notices. Unless the Administrator specifies otherwise, any notice to the Company under any Option Agreement or with respect to any Awards or Award Shares shall be in writing (or, if so authorized by Section 17.4, communicated electronically), shall be addressed to the Secretary of the Company, and shall only be effective when received by the Secretary of the Company.

Adopted by the Board on: April 4, 2002

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Approved by the stockholders on:

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Effective date of this Plan:

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(Footnote continued)





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3. In their discretion, the proxyholders are authorized to transact such other business as properly may come before the meeting or any adjournments or postponements of the meeting. The Board of Directors at present knows of no other business to be presented by or on behalf of the Company or the Board of Directors at the meeting.

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Date and sign exactly as name(s) appear(s) on this proxy. If signing for estates, trusts, corporations or other entities, title or capacity should be stated. If shares are held jointly, each holder should sign.

Signature:                      Date:                      Signature:                      Date:  
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