

DURECT CORP
Form DEF 14A
April 28, 2005

SCHEDULE 14A

(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities

Exchange Act of 1934 (Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

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

DURECT CORPORATION

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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(1) Amount Previously Paid:

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

(3) Filing Party:

(4) Date Filed:

DURECT CORPORATION

10240 Bubb Road

Cupertino, CA 95014

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

TO BE HELD JUNE 22, 2005

On Wednesday, June 22, 2005, DURECT Corporation, a Delaware corporation (the "Company"), will hold its Annual Meeting of Stockholders at the Company's headquarters, 10240 Bubb Road, Cupertino, CA 95014. The meeting will begin at 9:00 a.m. local time.

Only stockholders who owned stock at the close of business on April 25, 2005 can vote at this meeting or any adjournment that may take place. At the meeting we will:

- Elect the Class II directors of the Company's Board of Directors to serve until the Annual Meeting to be held in 2008.
- Amend the Company's 2000 Stock Plan.
- Amend the Company's 2000 Directors' Stock Option Plan.
- Ratify the appointment of Ernst & Young LLP as our independent registered public accounting firm for the current fiscal year.
- Transact any other business properly brought before the meeting.

You can find more information about each of these items, including the nominees for directors, in the attached Proxy Statement.

Our Board of Directors recommends that you vote in favor of each of the four proposals outlined in this Proxy Statement.

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We cordially invite all stockholders to attend the Annual Meeting in person. However, whether or not you expect to attend the Annual Meeting in person, please mark, date, sign and return the enclosed proxy card as promptly as possible in the postage-prepaid envelope provided to ensure your representation and the presence of a quorum at the Annual Meeting. If you send in your proxy card and then decide to attend the Annual Meeting to vote your shares in person, you may still do so. Your proxy is revocable in accordance with the procedures set forth in the Proxy Statement.

Following the meeting, we will also report on our business results and other matters of interest to stockholders.

By Order of the Board of Directors,

/s/ Jean I Liu

Jean I Liu

Senior Vice President, General Counsel and Secretary

Cupertino, California

April 28, 2005

DURECT CORPORATION

10240 Bubb Road

Cupertino, CA 95014

PROXY STATEMENT

FOR THE

2005 ANNUAL MEETING OF STOCKHOLDERS

JUNE 22, 2005

Our Board of Directors is soliciting proxies for the 2005 Annual Meeting of Stockholders. This Proxy Statement contains important information for you to consider when deciding how to vote on the matters brought before the meeting. Please read it carefully.

The Board set April 25, 2005, as the record date for the meeting. Stockholders of record who owned our common stock on that date are entitled to vote at and attend the meeting, with each share entitled to one vote. 51,932,587 shares of common stock were outstanding on the record date.

Voting materials, which include this Proxy Statement, a proxy card and the 2005 Annual Report, will be mailed to stockholders on or about May 11, 2005.

Our Annual Report on Form 10-K for the year ended December 31, 2004 is available on the Internet at our website at www.durect.com in the investor relations section or through the SEC's electronic data system called EDGAR at www.sec.gov. To request a printed copy of our Form 10-K, which we will provide to you without charge, either: write to Investor Relations, DURECT Corporation, 10240 Bubb Road, Cupertino, CA 95014 or e-mail Investor Relations at info@durect.com.

In this Proxy Statement:

- We, us, our and the Company refer to DURECT Corporation
- Annual Meeting or Meeting means our 2005 Annual Meeting of Stockholders

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- Board of Directors or Board means our Board of Directors
- SEC means the Securities and Exchange Commission

We have summarized below important information with respect to the Annual Meeting.

Time and Place of the Annual Meeting

The Annual Meeting is being held on Wednesday, June 22, 2005, at 9:00 a.m. local time at the Company's headquarters, 10240 Bubb Road, Cupertino, CA 95014. All stockholders who owned shares of our stock as of April 25, 2005, the record date, may attend the Annual Meeting.

Purpose of the Proxy Statement and Proxy Card

You are receiving a Proxy Statement and proxy card from us because you owned shares of our common stock on April 25, 2005, the record date. This Proxy Statement describes issues on which we would like you, as a stockholder, to vote. It also gives you information on these issues so that you can make an informed decision. When you sign the proxy card, you appoint James E. Brown and Felix Theeuwes as your representatives at the meeting. James E. Brown and Felix Theeuwes will vote your shares as you have instructed them on the proxy card, at the meeting. This way, your shares will be voted whether or not you attend the Annual Meeting. Even if you plan to attend the meeting it is a good idea to complete, sign and return your proxy card in advance of the meeting just in case your plans change.

Proposals to Be Voted on at This Year's Annual Meeting

You are being asked to vote on:

- The election of two (2) Class II directors to serve on our Board of Directors until our 2008 annual meeting of stockholders.
- The amendment of the Company's 2000 Stock Plan.
- The amendment of the Company's 2000 Directors' Stock Option Plan.
- The ratification of our appointment of Ernst & Young LLP as our independent registered public accounting firm for the current fiscal year.

The Board of Directors recommends a vote FOR each proposal.

Voting Procedure

You may vote by mail.

To vote by mail, please sign your proxy card and return it in the enclosed, prepaid and addressed envelope. If you mark your voting instructions on the proxy card, your shares will be voted as you instruct.

You may vote in person at the meeting.

We will pass out written ballots to anyone who wants to vote at the meeting. If you hold your shares in street name, you must request a legal proxy from your stockbroker in order to vote at the meeting. Holding shares in street name means your shares of stock are held in an account by your stockbroker, bank, or other nominee, and the stock certificates and record ownership are not in your name. If your shares are held in street name and you wish to attend the Annual Meeting, you must notify your broker, bank or other nominee and obtain the proper documentation to vote your shares at the Annual Meeting.

You may change your mind after you have returned your proxy.

If you change your mind after you return your proxy, you may revoke your proxy at any time before the polls close at the meeting. You may do this by:

- signing another proxy with a later date, or
- voting in person at the Annual Meeting.

Multiple Proxy Cards

If you received more than one proxy card, it means that you hold shares in more than one account. Please sign and return all proxy cards to ensure that all your shares are voted.

Quorum Requirement

Shares are counted as present at the meeting if the stockholder either:

- is present and votes in person at the meeting, or
- has properly submitted a proxy card.

A majority of our outstanding shares as of the record date must be present at the meeting (either in person or by proxy) in order to hold the Annual Meeting and conduct business. This is called a quorum.

Consequences of Not Returning Your Proxy; Broker Non-Votes

If your shares are held in your name, you must return your proxy (or attend the Annual Meeting in person) in order to vote on the proposals. If your shares are held in street name and you do not vote your proxy, your brokerage firm may either:

- vote your shares on routine matters, or
- leave your shares unvoted.

Under the rules that govern brokers who have record of ownership of shares that are held in street name for their clients, brokers may vote such shares on behalf of their clients with respect to routine matters (such as the election of directors or the ratification of auditors), but not with respect to non-routine matters (such as a proposal submitted by a stockholder). If the proposals to be acted upon at any meeting include both routine and non-routine matters, the broker may turn in a proxy card for uninstructed shares that vote FOR the routine matters, but expressly states that the broker is not voting on non-routine matters. This is called a broker non-vote. Proposals 2 and 3 in this proxy statement, Amendment of the Company's 2000 Stock Plan and Amendment of the Company's 2000 Directors' Stock Option Plan are non-routine matters.

Broker non-votes will be counted for the purpose of determining the presence or absence of a quorum, but will not be counted for the purpose of determining the number of votes cast.

We encourage you to provide instructions to your brokerage firm by voting your proxy. This ensures that your shares will be voted at the meeting.

Effect of Abstentions

Abstentions are counted as shares that are present and entitled to vote for the purposes of determining the presence of a quorum and as votes AGAINST for purposes of determining the approval of any matter submitted to the stockholders for a vote.

Required Vote

Assuming a quorum is present, the two nominees receiving the highest number of shares that are present and entitled to vote will be elected as Class II directors. Amendment of the Company's 2000 Stock Plan and 2000 Directors' Stock Option Plan and the ratification of the independent registered public accounting firm will require the affirmative vote of a majority of shares present in person or represented by proxy at the Meeting.

Vote Solicitation; No Use of Outside Solicitors

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DURECT Corporation is soliciting your proxy to vote your shares at the Annual Meeting. In addition to this solicitation by mail, our directors, officers, agents, and other employees may contact you by telephone, Internet, in person or otherwise to obtain your proxy. These persons will not receive any additional compensation for assisting in the solicitation. We will also request brokerage firms, nominees, custodians and fiduciaries to forward proxy materials to the beneficial owners. We will reimburse these entities and our transfer agent for their reasonable out-of-pocket expenses in forwarding proxy material. We have not retained the services of a proxy solicitor.

Voting Procedures

Votes cast by proxy or in person at the Annual Meeting will be tabulated by a representative of EquiServe, our transfer agent, who will act as the Inspector of Election. The Inspector will also determine whether a quorum is present at the Annual Meeting. The shares represented by the proxy cards received, properly marked, dated, signed and not revoked, will be voted at the Annual Meeting. If the proxy card specifies a choice with respect to any matter to be acted on, the shares will be voted in accordance with that specified choice. Any proxy card which is returned but not marked will be voted FOR each of the director nominees, FOR each of the other

proposals discussed in this Proxy Statement, and as the proxy holders deem desirable for any other matters that may come before the Meeting. Broker non-votes will not be considered as voting with respect to any matter for which the broker does not have voting authority.

We believe that the procedures to be used by the Inspector to count the votes are consistent with Delaware law concerning voting of shares and determination of a quorum.

Publication of Voting Results

We will announce preliminary voting results at the meeting. We will publish the final results in our quarterly report on Form 10-Q for the second quarter of 2005, which we will file with the SEC. You can get a copy on our website at www.direct.com in the investor relations section, by contacting Schond Greenway, our Executive Director of Investor Relations and Strategic Planning, at (408) 777-1417 or the SEC at (800) 732-0330 for the location of the nearest public reference room, or through the EDGAR system at www.sec.gov.

Other Business

We do not know of any business to be considered at the 2005 Annual Meeting other than the proposals described in this proxy statement. However, if any other business is properly presented at the Annual Meeting, your signed proxy card gives authority to James E. Brown and Felix Theeuwes to vote on such matters at their discretion.

Stockholder Proposals For 2006 Annual Meeting

To have your proposal included in our proxy statement for the 2006 Annual Meeting, you must submit your proposal in writing before December 29, 2005 to Jean Liu, Senior Vice President, General Counsel and Secretary, DURECT Corporation, 10240 Bubb Road, Cupertino, CA 95014.

If you submit a proposal for the 2006 Annual Meeting between February 22, 2006 and March 24, 2006, management may or may not, at their discretion, present the proposal at the meeting, and the proxies for the 2006 Annual Meeting will confer discretion on the management proxy holders to vote against your proposal.

PROPOSAL NO. 1
ELECTION OF DIRECTORS

Our Certificate of Incorporation provides that the Board of Directors is divided into three classes, with staggered three-year terms. The Class II directors, whose terms expire at the Annual Meeting of Stockholders and who are being nominated for re-election are David R. Hoffmann and Jon S. Saxe. The Class III directors whose terms expire at the Company's 2006 Annual Meeting of Stockholders are James E. Brown, Michael D. Casey and Armand P. Neukermans. The Class I directors whose terms expire at the Company's 2007 Annual Meeting of Stockholders are Felix Theeuwes and Simon X. Benito. You only elect one class of directors at each annual meeting. The other classes continue to serve for the remainder of their three-year terms. David R. Hoffmann and Jon S. Saxe, currently Class II directors, are nominees for re-election at the Annual Meeting. Each nominee has consented to serve an additional three-year term.

Vote Required

If a quorum is present, the two nominees within Class II receiving the highest number of affirmative votes of shares entitled to be voted for them will be elected as directors for the ensuing three years. Unless marked otherwise, proxies received will be voted FOR the election of each of the two nominees named held. If additional people are nominated for election as directors through the stockholder proposal process which includes written notification to the Company within specified time frames, the proxy holders intend to vote all proxies received by them in a way that will ensure that as many as possible of the nominees listed above are elected. If this happens, the specific nominees to be voted for will be determined by the proxy holders.

Nominees for the Board of Directors

Pursuant to the recommendation of our Nominating & Corporate Governance Committee, our Board of Directors has nominated the persons listed below to serve as directors for the term beginning at the Annual Stockholders Meeting on June 22, 2005. The names of the nominees, their ages as of April 25, 2005, and certain other information about them are set forth below:

<u>Name</u>	<u>Age</u>	<u>Position</u>
David R. Hoffmann (1)(2)(3)	60	Director
Jon S. Saxe (1)(2)	68	Director

David R. Hoffmann has served as a director since December 2002. Mr. Hoffmann is retired from ALZA Corporation (now a Johnson & Johnson company) where he held the positions of Vice President and Treasurer from 1992 to until his retirement in October 2002, Vice President of Finance from 1982 to 1992 and Director of Accounting/Finance from 1976 to 1982. Mr. Hoffmann is currently Chief Executive Officer of Hoffmann Associates, a multi-group company specializing in cruise travel and financial and benefit consulting, and a consultant of ALZA Corporation. Mr. Hoffmann holds a B.S. in Business from the University of Colorado.

Jon S. Saxe has served as a director since September 2003. Mr. Saxe is currently a director of a number of biotechnology and pharmaceutical companies including Protein Designs Labs, First Horizon Pharmaceuticals, SciClone, Questcor, InSite Vision, ID Biomedical Corporation and

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several private companies. From January 1995 to May 1999, Mr. Saxe was President of Protein Design Labs Inc. During 1999, he was an Executive-in-Residence at Institutional Venture Partners, a venture capital firm. Mr. Saxe was President of Saxe Associates, a biotechnology and pharmaceutical consulting firm, from May 1993 to December 1994. He served as President, Chief Executive Officer and as a director of Synergen, Inc., a biopharmaceutical company from October 1989 to April 1993. From August 1984 through September 1989, Mr. Saxe was Vice President, Licensing and Corporate Development at Hoffmann-LaRoche and also head of the patent law department and Associate General Counsel at the company from September 1978 through September 1989. Mr. Saxe received his B.S. in Chemical Engineering from Carnegie-Mellon University, a J.D. from George Washington University School of Law and an LL.M. from New York University School of Law.

Continuing Directors

The names of our continuing directors, their ages as of April 25, 2005 and certain other information about them are set forth below:

<u>Name</u>	<u>Age</u>	<u>Position</u>
James E. Brown, D.V.M.	48	President, Chief Executive Officer and Director
Felix Theeuwes, D.Sc.	67	Chairman and Chief Scientific Officer
Simon X. Benito	60	Director
Michael D. Casey (2)(3)	59	Director
Armand P. Neukermans, Ph.D.(1)(3)	64	Director
Thomas A. Schreck (4)	47	Chief Financial Officer and Director

- (1) Member of the Compensation Committee
(2) Member of the Audit Committee
(3) Member of the Nominating & Corporate Governance Committee
(4) Mr. Schreck is resigning as Chief Financial Officer and Director of the Company effective April 30, 2005.

James E. Brown, D.V.M. co-founded DURECT in February 1998 and has served as our President, Chief Executive Officer and a Director since June 1998. He previously worked at ALZA Corporation as Vice President of Biopharmaceutical and Implant Research and Development from June 1995 to June 1998. Prior to that, Dr. Brown held various positions at Syntex Corporation, a pharmaceutical company, including Director of Business Development from May 1994 to May 1995, Director of Joint Ventures for Discovery Research from April 1992 to May 1995, and held a number of positions including Program Director for Syntex Research and Development from October 1985 to March 1992. Dr. Brown holds a B.A. from San Jose State University and a D.V.M. (Doctor of Veterinary Medicine) from the University of California, Davis where he also conducted post-graduate work in pharmacology and toxicology.

Felix Theeuwes, D.Sc. co-founded DURECT in February 1998 and has served as our Chairman and Chief Scientific Officer since July 1998. Prior to that, Dr. Theeuwes held various positions at ALZA Corporation, including President of New Ventures from August 1997 to August 1998, President of ALZA Research and Development from 1995 to August 1997, President of ALZA Technology Institute from 1994 to April 1995 and Chief Scientist from 1982 to June 1997. Dr. Theeuwes is also a director of Genetronics, a medical device company. Dr. Theeuwes holds a D.Sc. degree in Physics from the University of Leuven (Louvain), Belgium. He also served as a post-doctoral fellow and visiting research assistant professor in the Department of Chemistry at the University of Kansas and has completed the Stanford Executive Program.

Simon X. Benito has served as a director since April 2005. Mr. Benito is currently a director and chairman of the Audit Committee of Inovio Biomedical Corporation, a publicly traded medical device company. From 1974 to 1999, Mr. Benito held various positions at Merck & Co Inc. including Senior Vice President, Vaccine Division from 1996 to 1999, Executive Vice President, Merck-Medco Managed Care from 1994 to 1996 and Executive Director and Vice President, Merck Human Health, Japan from 1986-1993. Mr. Benito was a Fellow of the Institute of Chartered Accountants in England and Wales from 1969 to 1999 until his retirement from Merck.

Michael D. Casey has served as a director since March 2004. Mr. Casey was Chairman, President and Chief Executive Officer of Matrix Pharmaceuticals, Inc. from September 1997 until February 2002 when Matrix was acquired by Chiron Corporation. From November 1995 until September 1997, Mr. Casey was President, Retail and Specialty Products Divisions of Schein Pharmaceutical, Inc. Mr. Casey was President and Chief Operating Officer of Genetic Therapy, Inc. from June 1993 until November 1995. Mr. Casey held various positions at Johnson & Johnson companies over a twenty-five year period, including serving as President of McNeil Pharmaceutical from July 1989 to June 1993. Mr. Casey is currently a director of a number of biotechnology and pharmaceutical companies including Bone Care International, Inc., Cholestech Corporation, Allos Therapeutics, Inc., Celgene Corporation and OrthoLogic Corporation.

Armand P. Neukermans, Ph.D. has served as a Director since March 2001. Dr. Neukermans founded Xros, Inc. in December 1996. Xros was acquired by and became a division of Nortel Networks in March 2000. Throughout and until June 2002, Dr. Neukermans has held the position of Chairman and Chief Technical Officer at Xros. In October 1993, Dr. Neukermans founded Adagio Associates, a consulting firm in the area of instrumentation, metrology and microfabrication and currently serves as its President. From 1992 to 1993, Dr. Neukermans was Vice President, Systems Development at Teknekron TSDC. Between 1985 and 1992, Dr. Neukermans held various positions at Tencor Instruments including Vice President and Chief Technical Officer. From 1973 to 1985, Dr. Neukermans held various positions at Hewlett Packard Company, HP Labs, including Department Manager. Dr. Neukermans holds an Engineer's Degree in Mechanical and Electrical Engineering from Louvain University, an M.S. in Electrical Engineering from Arizona State University and a Ph.D. in Applied Physics from Stanford University. Dr. Neukermans was named Silicon Valley Inventor of the year in 2001.

Thomas A. Schreck co-founded DURECT in February 1998 and served as Chief Executive Officer, Chief Financial Officer and President from February 1998 to June 1998. Since June 1998, he has served as our Chief Financial Officer and a Director. Prior to founding DURECT, he founded and was President of Schreck Merchant Group, Inc., an investment bank specializing in private placements and mergers and acquisitions, from June 1994 to February 1998. Mr. Schreck also founded and served as Risk Manager to Genesis Merchant Group/Portola Capital Partners, L.P., a convertible arbitrage fund, from 1993 to 1994. He also served as a Manager of the Convertible Securities Department at Montgomery Securities, from 1988 to 1991. Mr. Schreck holds a B.A. from Williams College.

There are no family relationships among any of the directors or executive officers of the Company.

The Board, Board Committees and Meetings

Corporate governance is typically defined as the system that allocates duties and authority among a company's stockholders, board of directors and management. The stockholders elect the board and vote on extraordinary matters; the board is the company's governing body, responsible for hiring, overseeing and evaluating management, particularly the Chief Executive Officer; and management runs the company's day-to-day operations. Our Board of Directors currently consists of 8 directors, as described in Proposal 1: Election of Directors. Mr. Schreck is resigning from our Board of Directors effective April 30, 2005, whereupon we will have 7 directors until Mr. Schreck's replacement is qualified and appointed.

Independent Directors. Each of our directors other than Messrs. Theeuwes, Schreck and Brown qualify as independent in accordance with the published listing requirements of NASDAQ as of June 22, 2005, the date of our annual meeting. The NASDAQ independence definition includes a series of objective tests, such as that the director is not an employee of the company and has not engaged in various types of business dealings with the Company. In addition, as further required by the NASDAQ rules, the Board has made a subjective determination as to each independent director that no relationships exist which, in the opinion of the Board, would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. In making these determinations, the directors reviewed and discussed information provided by the directors and the company with regard to each director's business and personal activities as they may relate to us and our management.

Board Responsibilities and Structure. The primary responsibilities of the Board are oversight, counseling and direction to our management in the long-term interests of the Company and its stockholders. The Chief Executive Officer and management are responsible for seeking the advice and, in appropriate situations, the approval of the Board with respect to extraordinary actions to be undertaken by the Company.

The Board and its committees meet throughout the year on a set schedule, and also hold special meetings and act by written consent from time to time as appropriate. The Board has delegated various responsibilities and authority to different Board committees as described in this section of the proxy statement. Committees regularly report on their activities and actions to the full Board.

Board Committees and Charters. The Board currently has, and appoints the members of, standing Audit, Compensation and Nominating & Corporate Governance Committees. Each of the Board committees has a written charter approved by the Board. Copies of each charter are available on our web site at www.direct.com under About DURECT Corporate Policies/Governance.

Audit Committee. The Audit Committee assists the Board in its general oversight of our financial reporting, internal controls and audit functions, and is directly responsible for the appointment, retention, compensation and oversight of the work of our independent registered public accounting firm. In 2004, the Audit Committee held four meetings. The responsibilities and activities of the Audit Committee are described in greater detail in the Audit Committee Report. At the end of the last fiscal year, the Audit Committee was composed of the following directors: Michael D. Casey, David R. Hoffmann and Jon S. Saxe. In March 2004, Michael D. Casey was elected to the Audit Committee to replace Dr. Neukermans. Mr. Saxe was elected to be Chairman of the Committee in March 2004. In September 2004, Mr. Hoffmann was elected to be Chairman of the Committee.

Among other matters, the Audit Committee monitors the activities and performance of our external auditors, including the audit scope, external audit fees, auditor independence matters and the extent to which the independent registered public accounting firm may be retained to perform non-audit services. Our independent registered public accounting firm provides the Audit Committee with the written disclosures and the letter required by Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees, and the Audit Committee discusses with the independent registered public accounting firm and management that firm's independence.

In accordance with Audit Committee policy and the requirements of law, all services to be provided by Ernst & Young are pre-approved by the Audit Committee. Pre-approval includes audit services, audit-related services, tax services and other services. In its pre-approval and review of non-audit service fees, the Audit Committee considers, among other factors, the possible effect of the performance of such services on the auditors' independence. To avoid certain potential conflicts of interest in maintaining auditor independence, the law prohibits a publicly traded company from obtaining certain non-audit services from its auditing firm.

As required by NASDAQ rules, the members of the Audit Committee each qualify as independent under special standards established for members of audit committees. The Audit Committee also includes at least one member who is determined by the Board to meet the qualifications of an audit committee financial expert in accordance with SEC rules. David R. Hoffmann is the director who has been determined to be the Audit Committee financial expert. Stockholders should understand that this designation is a disclosure requirement of the SEC related to Mr. Hoffmann's experience and understanding with respect to certain accounting and auditing matters. The designation does not impose upon Mr. Hoffmann any duties, obligations or liability that are greater than are generally imposed on him as a member of the Audit Committee and the Board, and his designation as an audit committee financial expert pursuant to this SEC requirement does not affect the duties, obligations or liability of any other member of the Audit Committee or the Board.

Compensation Committee. The Compensation Committee reviews and approves salaries, performance-based incentives and other matters relating to executive compensation, and administers our stock option plans, including reviewing and granting stock options to executive officers. The Compensation Committee also reviews and approves various other company compensation policies and matters. The Compensation Committee held seven meetings in 2004 and also regularly acts by written consent. For more information, see the Compensation Committee Report on Executive Compensation. At the end of the last fiscal year, the Compensation Committee was composed of David R. Hoffmann, Armand P. Neukermans, and Jon S. Saxe. Dr. Neukermans was elected to be Chairman of the Committee in March 2004. As required by NASDAQ rules, the members of the Compensation Committee each qualify as independent under special standards established for members of compensation committees.

Nominating & Corporate Governance Committee. The Nominating & Corporate Governance Committee identifies, evaluates and recommends to the Board individuals, including individuals proposed by stockholders, qualified to serve as members of the Board and the nominees for election as directors of the Company at the next annual or special meeting of stockholders at which directors are to be elected. The Nominating & Corporate Governance Committee also identifies, evaluates and recommends to the Board individuals to fill any vacancies or newly created directorships that may occur between such meetings. The Nominating & Corporate Governance Committee was established in April 2004 and had two meetings in 2004. In December 2004, after an amendment to the Committee charter, the Nominating & Corporate Governance Committee also became responsible for preparing and recommending to the Board adoption of corporate governance guidelines, reviewing and assessing our Code of Ethics and overseeing and conducting an annual evaluation of the performance of the Board. The members of the Nominating & Corporate Governance Committee are Michael D. Casey, David R. Hoffmann and Armand P. Neukermans. Mr. Casey was elected to be Chairman of the Committee in April 2004. As required by NASDAQ rules, the members of the Nominating & Corporate Governance Committee each qualify as independent under special standards established for members of the Committee.

Criteria for Board Membership. In recommending candidates for appointment or re-election to the Board, the Nominating & Corporate Governance Committee considers the appropriate balance of experience, skills and characteristics required of the Board of Directors, and seeks to insure that at least a majority of the directors are independent under the NASDAQ rules, and that members of the Company's Audit Committee meet the financial literacy and sophistication requirements under the NASDAQ rules and at least one of them qualifies as an audit committee financial expert under the rules of the SEC. Nominees for director are selected on the basis of their depth and breadth of experience, integrity, ability to make independent analytical inquiries, understanding of the Company's business environment, and willingness to devote adequate time to Board duties.

Stockholder Nominees. The Nominating & Corporate Governance Committee will consider written proposals from stockholders for nominees for director. Any such nominations should be submitted to the Nominating & Corporate Governance Committee c/o Jean Liu, Sr. Vice President, General Counsel and Secretary, 10240 Bubb Road, Cupertino, CA 95014 and should include the following information: (a) all information relating to such nominee that is required to be disclosed pursuant to Regulation 14A under the Securities Exchange Act of 1934 (including such person's written consent to being named in the proxy statement as a nominee and to serving as a director if elected); (b) the names and addresses of the stockholders making the nomination and the number of shares of the Company's common stock which are owned beneficially and of record by such stockholders; and (c) appropriate biographical information and a statement as to the qualification of the nominee, and should be submitted in the time frame described in the Bylaws of the Company and under the caption, Stockholder Proposals for 2006 Annual Meeting above.

Process for Identifying and Evaluating Nominees. The Nominating & Corporate Governance Committee believes the Company is well-served by its current directors. In the ordinary course, absent special circumstances or a material change in the criteria for Board membership, the Nominating & Corporate Governance Committee will renominate incumbent directors who continue to be qualified for Board service and are willing to continue as directors. If an incumbent director is not standing for re-election, or if a vacancy on the Board occurs between annual stockholder meetings, the Nominating & Corporate Governance Committee will seek out potential candidates for Board appointment who meet the criteria for selection as a nominee and have the specific qualities or skills being sought. Director candidates will be selected based on input from members of the Board, senior management of the Company, stockholder nominations, and, if the Nominating & Corporate Governance Committee deems appropriate, a third-party search firm. The Nominating & Corporate Governance Committee will evaluate each candidate's qualifications and check relevant references; in addition, such candidates will be interviewed by at least one member of the Nominating & Corporate Governance Committee. Candidates meriting serious consideration will then meet with the members of the Board. Based on this input, the Nominating & Corporate Governance Committee will evaluate which of the prospective candidates is qualified to serve as a director and whether the committee should recommend to the Board that this candidate be appointed to fill a current vacancy on the Board, or presented for the approval of the stockholders, as appropriate.

Attendance at Board, Committee and Annual Stockholders Meetings. During the last fiscal year (the period from December 31, 2003 through December 31, 2004), the Board met six times. All directors are expected to attend each meeting of the Board and the committees on which they serve, and are also strongly encouraged to attend our annual meeting of stockholders. Each director, except Mr. Albert Zesiger, who retired from our board in April 2005, attended at least 75% of all Board and applicable committee meetings during this time. Seven directors attended our 2004 annual meeting of stockholders.

Communications from Stockholders to the Board. The Board recommends that stockholders initiate any communications with the Board in writing and send them in care of the Secretary. Stockholders can send communications by e-mail to jean.liu@durect.com, by fax to (408) 777-3577 or by mail to Jean Liu, Sr. Vice President, General Counsel and Secretary, DURECT Corporation, 10240 Bubb Road, Cupertino, California 95014. This centralized process will assist the Board in reviewing and responding to stockholder communications in an appropriate manner. The name of any specific intended Board recipient should be noted in the communication. The Board has instructed the Secretary to forward such correspondence only to the intended recipients; however, the Board has also instructed the Secretary, prior to forwarding any correspondence, to review such correspondence and, in her discretion, not to forward certain items if they are deemed of a commercial or frivolous nature or otherwise inappropriate for the Board's consideration. In such cases, some of that correspondence may be forwarded elsewhere in the Company for review and possible response.

Code of Ethics

In December 2003, the Board approved an amended Code of Ethics applicable to all of our employees, officers and directors. The purpose of the Code of Ethics is to deter wrongdoing and among other things, promote compliance with applicable laws, fair dealing, proper use and protection of Company assets, prompt and accurate public company reporting, reporting of accounting complaints or concerns and avoidance of conflicts of interest and usurpation of corporate opportunity.

Our Code of Ethics can be found on our corporate website at www.durect.com under About DURECT Corporate Policies/Governance. If the Company makes any substantive amendments to the Code or grants any waiver from a provision of the Code to any executive officer or director, the Company will promptly disclose the nature of the amendment or waiver by a method selected by the Board of Directors and in conformity with applicable SEC and NASDAQ rules.

Whistleblower Policy

In December 2003, in compliance with Section 301 of the Sarbanes-Oxley Act, the Audit Committee of the Board of Directors established procedures for the receipt, retention, and treatment of complaints received by the company regarding accounting, internal accounting controls, or auditing matters, and confidential, anonymous employee submissions of concerns regarding questionable accounting or auditing matters (Whistleblower Policy). Our Whistleblower Policy can be found on our corporate website at www.durect.com under About DURECT Corporate Policies/Governance.

Director Compensation

In 2004, each non-employee director except Mr. Zesiger received an attendance fee of \$1,000 for each Board meeting attended and \$500 for each telephonic Board meeting or committee meeting attended and a retainer fee equal to \$10,000 per year, paid on a quarterly basis in arrears. Directors other than Mr. Zesiger were also reimbursed reasonable and customary travel expenses. Effective April 2005, the Board amended the board compensation plan to provide that each non-employee director is eligible to receive an attendance fee of \$1,500 for each Board meeting

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attended and \$500 for each telephonic Board meeting and a retainer fee equal to \$12,500 per year paid on a quarterly basis in arrears. In addition, under the amended compensation plan, for each Board committee on which a non-employee director serves, he shall be eligible to receive an attendance fee of \$500 for

each committee meeting attended and a retainer fee equal to \$2,000 per year paid on a quarterly basis in arrears. Under the amended compensation plan, the chairperson of the Audit Committee or other Board Committee will also be eligible to receive an additional retainer fee of \$7,500 per year or \$4,000 per year respectively, each paid on a quarterly basis in arrears.

All of our current non-employee directors participate in the 2000 Directors' Stock Option Plan. Under the Directors' Plan, when each non-employee director first becomes a director, he/she receives nonstatutory options to purchase 30,000 shares of our common stock. These options have a ten-year term and become exercisable in installments of 33 1/3% of the total number of shares granted on each anniversary of the grant. On the date of our annual stockholders' meeting each year, each director who has served for at least 6 months will receive options to purchase an additional 12,000 shares of our common stock (Annual Grant). In April 2005, subject to stockholder approval, the Board approved amendments and restatements of the Directors' Plan to increase the Annual Grant from 12,000 to 20,000 shares and to provide that such Annual Grant would vest on the day before the annual meeting of the year after grant (see Proposal No. 3). These options are for a ten-year term. In each case, the size of the option grants would be adjusted to reflect any stock splits, stock dividends, combinations or similar transactions. The exercise price of the options granted under the Directors' Plan must be at least 100% of the closing price of our common stock on the NASDAQ National Market on the date the option is granted. The options may be exercised only (1) while the individual is serving as a director on the Board, (2) within 12 months after termination by death or disability, or (3) within 3 months after the individual's term as director ends for any other reason.

Each of the non-employee directors named in this proxy statement will receive an additional option to purchase 12,000 shares of our common stock under the Directors' Plan on June 22, 2005, the date of our 2005 Annual Meeting.

Employee directors receive no additional compensation for serving on the Board of Directors.

Recommendation of the Board:

THE BOARD RECOMMENDS A VOTE *FOR*
THE ELECTION OF ALL NOMINEES NAMED ABOVE.

PROPOSAL NO. 2

AMENDMENTS OF THE COMPANY'S 2000 STOCK PLAN

At the Annual Meeting, you are being asked to approve amendments to the 2000 Stock Plan (the "Stock Plan"). On April 14, 2005, the Board approved, subject to stockholder approval, amendments of the Stock Plan which affects the following changes:

- expansion of the types of awards that the Company may grant to eligible service providers under the Stock Plan to include restricted stock grants, restricted stock units, stock appreciation rights and other similar types of awards (including other awards under which recipients are not required to pay any purchase or exercise price) as well as cash awards; and
- inclusion of certain performance criteria (as described further below) that may be applied to awards granted under the Stock Plan.

The Stock Plan was adopted by the Board of Directors in January 31, 2000 and it became effective on January 31, 2000 after approval of the stockholders. In April 2005, the Board approved amendments of the Plan, subject to stockholder approval, to make the changes specified above.

The Board adopted the changes to the Stock Plan because it believes that expanding the types of equity awards permitted under the Stock Plan is necessary to attract and retain employees, executive officers, directors and other service providers while providing the Company flexibility to structure such awards in the manner most beneficial to the Company and its stockholders. The Board also believes it is in the best interests of the Company and its stockholders to maximize the Company's ability to take income tax deductions for certain compensation paid to executive officers of the Company under Section 162(m) (Section 162(m)) of the Internal Revenue Code of 1986, as amended (the "Code"). The Board continues to believe that equity compensation awards are an important part of the Company's overall compensation program and that such awards are important in retaining and motivating existing personnel.

As amended, the material terms of the Stock Plan include the following:

- an aggregate of 1,796,500 shares of common stock were originally reserved for issuance under the Stock Plan. In addition, pursuant to provisions approved by our stockholders in January 2000, for each of our fiscal years from 2001 through 2005 an additional number of shares equal to 2,250,000 shares per year have been added to the plan, and for each fiscal year from 2006 through 2010, an additional number of shares equal to the lesser of 2,250,000 shares, 5% of our outstanding stock or a lesser number of shares as is determined by the Board will automatically be added to the number of shares reserved for issuance on the first day of each of our fiscal years through 2010. You are not being asked to vote to increase the number of shares available for issuance under the Stock Plan;
- the types of awards that may be granted under the Stock Plan are stock options (including incentive stock options and nonstatutory stock options), restricted stock grants, restricted stock units, stock appreciation rights, stock purchase rights, and other similar types of awards (including other awards under which recipients are not required to pay any purchase or exercise price), as well as cash awards;
- the maximum number of shares subject to awards that may be granted to any one participant under the Stock Plan during any single fiscal year of the Company is 1,500,000 shares;

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- the Company may not reprice or otherwise reduce the exercise price of outstanding options granted under the Stock Plan (other than in connection with certain corporate transactions such as stock splits, stock dividends or similar transactions) without the approval of our stockholders; and
- the number of shares reserved for issuance under the Stock Plan and subject to outstanding awards, the exercise or purchase price per share applicable to outstanding awards and the maximum number of shares that may be issued to any participant during a fiscal year will be adjusted to proportionately reflect the terms of certain corporate transactions including stock splits, stock dividends, and certain other transactions affecting the capital stock of the Company.

Expansion of Types of Awards and Extension of Plan Term

Currently, the Stock Plan provides for the granting of stock options and stock purchase rights to eligible participants. In light of the changing pressures affecting compensation, including executive compensation, as a result of the recent market developments as well as increased focus on corporate governance matters generally, and because of the anticipated effectiveness of Financial Accounting Standards 123R imposing significant changes to the accounting treatment of stock options, our Board believes it appropriate for us to have increased flexibility as to the types of equity compensation awards the Board may grant to employees and other eligible plan participants.

Specifically, our Board has determined that the Company would be better positioned to attract and retain qualified officers, employees, consultants and directors if we had the ability, in addition to being able to grant stock options and rights to purchase shares of our common stock, to grant stock awards in the form of restricted stock, restricted stock units and stock appreciation rights and other similar types of stock awards pursuant to which the recipient is not required to make any payment to the Company upon issuance of the shares underlying the award. In addition, the Board desires that the Company be able to pay cash bonuses that are fully deductible by the Company under applicable tax rules. These awards may or may not be granted subject to vesting or other forfeiture conditions. We seek approval of our stockholders to expand the types of awards granted under the Stock Plan and extension of the Stock Plan's term.

Background on Section 162(m) Approval

We are also asking our stockholders to approve the material terms of the Stock Plan to maximize the corporate income tax deductions that may become available to us pursuant to Section 162(m). We are asking our stockholders for this approval so that we may deduct for federal income tax purposes compensation in excess of \$1.0 million that may be paid to certain executive officers in any single year. Compensation includes cash compensation and income arising from the exercise of nonstatutory stock options, as a result of the grant or vesting of other types of equity awards, and from disqualifying dispositions of incentive stock options.

Pursuant to Section 162(m), we generally may not deduct for federal income tax purposes compensation paid to certain executive officers (our Chief Executive Officer and our other four most highly compensated executive officers) to the extent that any of these persons receive more than \$1.0 million in compensation in any single year. However, if the compensation qualifies as performance-based for Section 162(m) purposes, we may deduct it for federal income tax purposes even if it exceeds \$1.0 million in a single year. To assure that stock options granted under the Stock Plan in the future qualify as performance-based compensation under Section 162(m), we believe our stockholders should approve the material terms of the Stock Plan at the Annual Meeting. One of the material terms of the Stock Plan is that the maximum number of shares that may be granted subject to options and other stock awards under the Stock Plan to any employee during any single fiscal year is 1,500,000 shares. This limit is included in the Stock Plan specifically for purposes of Section 162(m).

In addition, we are seeking to expand the types of awards granted under the Stock Plan to include restricted stock grants, restricted stock units and stock appreciation rights (and other similar types of awards), as well as cash awards. To qualify such awards as performance-based compensation, these awards must be made subject to performance conditions approved by the Board's Compensation Committee and our stockholders as required under the Section 162(m) regulations. The Company may or may not apply performance criteria and qualify the awards under Section 162(m), but the Company believes it is in the best interests of the Company and its stockholders to have the ability to do so.

The Stock Plan, as amended, would permit the Company to issue such awards incorporating performance objectives and would provide that these performance objectives (Qualifying Performance Criteria) may be based upon: (1) cash flow, (2) earnings (including gross margin, earnings before interest and taxes, earnings before taxes, and net earnings), (3) earnings per share, (4) growth in earnings or earnings per share; (5) stock price, (6) return on equity or average stockholders' equity, (7) total stockholder return, (8) return on capital, (9)

return on assets or net assets, (10) return on investment, (11) revenue, (12) income or net income, (13) operating income or net operating income, (14) operating profit or net operating profit, (15) operating margin, (16) return on operating revenue, (17) market share, (18) contract awards or backlog, (19) overhead or other expense reduction, (20) growth in stockholder value relative to the moving average of the S&P 500 Index or the Company's peer group index, (21) credit rating, (22) strategic plan development and implementation, (23) improvement in workforce diversity, and (24) such other similar criteria as may be determined by the Administrator (as defined below). To the extent that the Administrator determines that an award will be granted subject to Qualifying Performance Criteria, such criteria will be specified with respect to a particular award by our compensation committee in a manner designed to comply with Section 162(m). These criteria may be applied to the Company as a whole or to a business unit, parent, subsidiary or business segment, either individually, alternatively or in any combination, and may be measured either annually or cumulatively over a period of years, on an absolute basis, or relative to a pre-established target, to previous years' results or to a designated comparison group, in each case as specified by the Administrator in the award agreement. The Company generally attempts to ensure that any awards under the Stock Plan meet the standards of Section 162(m) but may not do so in every instance.

Stockholder approval of the Stock Plan as amended pursuant to this proposal will constitute stockholder approval of the material terms of the Plan, including the limitations on stock awards and cash awards and the Qualifying Performance Criteria, for Section 162(m) purposes.

Recommendation of the Board:

**THE BOARD RECOMMENDS A VOTE *FOR*
AMENDMENT OF THE 2000 STOCK PLAN.**

General Plan Background

As of April 25, 2005, awards (net of expired or canceled awards) covering an aggregate of 8,684,497 shares of common stock had been granted under the Stock Plan. 4,362,003 shares of common stock (plus (a) any shares that might in the future be returned to the Stock Plan as a result of expiration of awards or as a result of being retained by the Company to pay the exercise or purchase price or withholding taxes due upon exercise, purchase or issuance of awards, (b) shares added to the Stock Plan based on an annual increase on the first day of each of the Company's fiscal years in 2006 through 2010 equal to the lesser of 2,250,000 shares of common stock, 5% of the shares of common stock outstanding on the last day of the immediately preceding fiscal year or a lesser number determined by the Board) remain available for future grant under the Stock Plan.

Summary of the Stock Plan

A copy of the Stock Plan, as amended, is attached to this proxy statement as Appendix A. The following description of the Stock Plan is only a summary and so is qualified by reference to the complete text of the Stock Plan. Except as otherwise noted, this summary reflects the amendments proposed above.

General

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The purpose of the Stock Plan is to offer incentives to attract and retain the best available personnel for positions of substantial responsibility and by providing additional incentive to employees and consultants to promote the success of the Company's business. Stock options, stock purchase rights and subject to stockholder approval, restricted stock, restricted stock units, stock appreciation rights and cash awards may be granted under the Stock Plan (each an Award). Options granted under the Stock Plan may be either incentive stock options, as defined in section 422 of the Code, or non-statutory stock options.

Administration. The Stock Plan is administered by the Board of Directors or a committee designated by the Board (the Administrator).

Eligibility. Nonstatutory stock options and stock awards may be granted under the Stock Plan to employees, directors (including non-employee directors) and consultants of the Company, its parent and subsidiaries. Incentive stock options and cash awards may be granted only to employees of the Company or its subsidiaries. The Administrator, in its discretion, selects the employees to whom stock options and other stock awards, as well as cash awards, may be granted, the time or times at which such awards are granted, and the terms of such awards to be granted under the Stock Plan. As of April 25, 2005, the Company had approximately 147 employees and consultants and 5 non-employee directors who would be eligible to participate in the Stock Plan.

The following table sets forth information with respect to the stock options granted to the Named Executive Officers, all executive officers as a group, all directors who are not executive officers as a group, and all employees and consultants (excluding executive officers) as a group under the Stock Plan as of April 25, 2005.

Name	Number of shares subject to options granted under	Weighted average exercise price
	the Stock Plan	per share
James E. Brown, D.V.M.	630,000	\$ 3.77
Felix Theeuwes, D.Sc.	655,000	\$ 3.69
Thomas A. Schreck (1)	505,000	\$ 3.92
Timonthy S. Nelson (2)	402,107	\$ 4.54
Steven C. Halladay, Ph.D.	281,250	\$ 2.81
All executive officers as a group (10 persons)	3,856,607	\$ 3.64
All directors who are not executive officers (3 persons)	55,000	\$ 5.22
All current and former employees and consultants (excluding executive officers) as a group (245 persons)	8,013,020	\$ 4.43

- (1) Mr. Schreck is resigning as Chief Financial Officer and Director of the Company effective April 30, 2005.
(2) Mr. Nelson's employment with us ended in April 2005.

New Plan Benefits. Because benefits under the Stock Plan will depend on the Administrator's actions and, with respect to options and other stock awards, the fair market value of common stock at various future dates, it is not possible to determine the benefits that will be received by employees, officers, directors, and consultants under such types of awards if the Stock Plan is approved by the stockholders. As of April 25, 2005, the closing sales price of common stock was \$2.85 per share. No cash awards have been granted under the Stock Plan.

Nontransferability of Awards. Unless otherwise determined by the Administrator, options and stock awards granted under the Stock Plan are not transferable other than by will or the laws of descent and distribution and may be exercised during the lifetime of the holder of the option or stock award only by the holder.

Stock Options

Exercise Price. The Administrator determines the exercise price of options at the time the options are granted. The exercise price of an incentive stock option may not be less than 100% of the fair market value of our common stock on the date of grant of such option, and the exercise price of an incentive stock option to an employee who is also a 10% stockholder must have an exercise price at least equal to 110% of the fair market value of our common stock on the date of grant of such option. The exercise price of a non-statutory stock option is as determined by the Administrator provided that if the optionee is, at the time of the grant of a non-statutory stock option, a Named Executive Officer of the Company or an individual whom the Administrator reasonably believes may become a Named Executive Officer, then the exercise price may not be less than 100% of the fair market value of our common stock on the date of grant if such option is intended to qualify

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as performance-based compensation under Section 162(m). The Company may grant options with exercise prices less than 100% of the fair market value of our common stock on the date of grant in connection with an acquisition by the Company of another company. The fair market value of our common stock is generally the closing sales price as quoted on

the Nasdaq National Market on the date of grant. No option may be repriced to reduce the exercise price of such option without stockholder approval (except in connection with a change in our capitalization, such as a stock split or a recapitalization).

Exercise of Option; Form of Consideration. The Administrator determines when options vest and become exercisable, and in its discretion may accelerate the vesting and/or exercisability of any outstanding option. The Company's standard vesting schedule applicable to options is 1/4 of the total shares vesting at each 12-month anniversary of the grant date. The means of payment for shares issued upon exercise of an option are specified in each option agreement. The Stock Plan permits payment to be made by cash, check, promissory note, cancellation of indebtedness, other shares of common stock of the Company (with some restrictions), broker assisted same-day sale, withholding of shares subject to the option (with some restrictions) or any other means of consideration permitted by applicable law.

Term of Option. The term of an option may be no more than ten years from the date of grant; provided that the term of an incentive stock option may not be more than five years from the date of grant for an optionee who is also a 10% stockholder. No option may be exercised after the expiration of its term.

Termination of Options. Generally, if an optionee's service to the Company as an employee, consultant or director terminates other than for death or disability, vested options will remain exercisable for a period of three months following the optionee's termination. Unless otherwise provided for in the option agreement, generally if an optionee becomes disabled while an employee, consultant or director, the optionee's vested options shall be exercisable for six months following the optionee's termination as a result of disability, or if earlier, the expiration of the term of such option. Unless otherwise provided for in the option agreement, if an optionee dies during optionee's service with the Company or within 30 days following termination of optionee's service, optionee's vested options shall be exercisable for 6 months following the optionee's death, or if earlier, the expiration of the term of such option. The Administrator shall have the authority to extend the period of time for which an option is to remain exercisable following optionee's termination; provided that in no event will an option be exercisable later than the expiration of the term of the option.

Stock Awards

Stock awards may be stock grants, stock purchase rights, stock units or stock appreciation rights. Stock grants are awards of a specific number of shares of our common stock. Stock purchase rights are rights to purchase our common stock. Stock units represent a promise to deliver shares of our common stock, or an amount of cash or property equal to the value of the underlying shares, at a future date. Stock appreciation rights are rights to receive cash and/or shares of our common stock based on a change in the fair market value of a specific number of shares of our common stock. Each stock award is evidenced by a stock award agreement between the Company and the participant. The Stock Plan allows the Administrator broad discretion to determine the terms of individual awards, including the number of shares that such participant shall be entitled to purchase or receive and the price (if any) to be paid by the recipient in connection with the issuance of the shares. Each stock award agreement will contain provisions regarding (i) the number of shares subject to such stock award or a formula for determining such number, (ii) the purchase price of the shares, if any, and the means of payment for the shares, (iii) the performance criteria (including the Qualifying Performance Criteria), if any, and level of achievement versus these criteria that will determine the number of shares granted, issued, retainable and vested, as applicable, (iv) such terms and conditions on the grant, issuance, vesting and forfeiture of the shares, as applicable, as may be determined from time to time by the Administrator, (v) restrictions on the transferability of the stock award, and (vi) such further terms and conditions, in each case not inconsistent with the Stock Plan, as may be determined from time to time by the Administrator. Shares may be granted under the Stock Plan as stock awards without requiring the participant to pay the Company an amount equal to the fair market value of our common stock as of the Award grant date in order to acquire the Award shares.

Cash Awards

Each cash award granted under the Stock Plan will be subject to Qualifying Performance Criteria and will be reflected in an agreement containing provisions regarding (1) the target and maximum amount payable to the participant as a cash award, (2) the Qualifying Performance Criteria and level of achievement versus the criteria that will determine the amount of such payment, (3) the period as to which performance shall be measured for establishing the amount of any payment, (4) the timing of any payment earned by virtue of performance, (5) restrictions on the alienation or transfer of the cash award prior to actual payment, (6) forfeiture provisions, and (7) such further terms and conditions, in each case not inconsistent with the Stock Plan, as may be determined from time to time by the Administrator. The maximum amount payable as a cash award that is settled for cash may be a multiple of the target amount payable. The maximum amount payable pursuant to a cash award granted under the Stock Plan for any fiscal year intended to satisfy the requirements to performance based compensation under Section 162(m) may not exceed \$1,000,000. Nothing in the Stock Plan prevents the Company from granting cash awards outside of the Stock Plan to any individual.

Adjustments on Changes in Capitalization, Merger or Change of Control

In the event of any stock dividend, stock split, reverse stock split, recapitalization, combination, reclassification or similar change to the capital structure of the Company without receipt of consideration by the Company, appropriate adjustments will be made to (i) the number of shares subject to the Stock Plan (including the number of shares added annually to the Stock Plan), (ii) the number of shares that may be awarded to any individual under the Stock Plan during a single fiscal year, and (iii) the exercise price and number of shares under each outstanding Award. Any such adjustments shall be made by the Administrator, and the decision of the Administrator shall be final, binding and conclusive.

In the event of a change in control of the Company as defined in the Stock Plan, each outstanding Award shall be assumed or an equivalent Award shall be substituted by the successor corporation or a parent or subsidiary of such successor corporation, unless the successor corporation does not agree to assume such Award, in which case such Award shall accelerate immediately prior to the consummation of the transaction.

In the event of a proposed dissolution or liquidation of the Company, each Award will terminate immediately prior to the consummation of the dissolution or liquidation, unless otherwise determined by the Administrator.

Amendment and Termination of the Stock Plan

The Board may amend, alter, suspend or discontinue the Stock Plan. However, the Company shall obtain stockholder approval for any amendment to the Stock Plan to the extent necessary and desirable to comply with applicable laws and Nasdaq National Market listing requirements. Generally, no such action by the Board or stockholders may alter or impair any outstanding Award under the Stock Plan without the written consent of the holder. In addition, no amendment shall be made that would reduce the exercise price of outstanding options without the written consent of the stockholders. The Stock Plan will terminate in January 2010.

Federal Income Tax Consequences of Options under the Stock Plan

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 PLAN. IT DOES NOT DESCRIBE STATE OR

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OTHER TAX CONSEQUENCES OF THE ISSUANCE AND EXERCISE OF OPTIONS OR OF AWARDS OF RESTRICTED STOCK.

Options. The grant of an incentive stock option 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 incentive stock option until more than two years after the option grant date and more than one year after exercise of the option, any gain (or loss) upon sale of the shares will be a long-term capital gain (or loss). 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 incentive stock options, except to the extent that the optionee has taxable ordinary income on a disqualifying disposition (unless limited by Section 162(m)).

The grant of a nonstatutory option has no federal income tax effect on the optionee. Upon the exercise of a non-statutory option, the optionee has taxable ordinary income (and unless limited by Section 162(m) the Company is 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 non-statutory option, the optionee recognizes either long-term or short-term capital gain or loss, depending on how long such stock was held, on any difference between the sale price and the exercise price, to the extent not recognized as taxable income on the date of exercise. The Company may allow non-statutory options to be transferred subject to conditions and restrictions imposed by the Administrator; special tax rules may apply on such a transfer.

In the case of both incentive stock options and non-statutory options, special federal income tax rules apply if Company common stock is used to pay all or part of the option price.

Stock Awards. Stock awards will generally be taxed in the same manner as nonstatutory stock options. However, shares issued under a restricted stock award are subject to a substantial risk of forfeiture within the meaning of Section 83 of the Code to the extent the shares will be forfeited in the event that the participant ceases to provide services to the Company and are not nontransferable. As a result of this substantial risk of forfeiture, the participant will not recognize ordinary income at the time the award shares are issued. Instead, the participant will recognize ordinary income on the dates when the stock is no longer subject to a substantial risk of forfeiture, or when the stock becomes transferable, if earlier. The participant's ordinary income is measured as the difference between the amount paid for the stock, if any, and the fair market value of the stock on the date the stock is no longer subject to forfeiture.

The employee may accelerate his or her recognition of ordinary income, if any, and begin his or her capital gains holding period by timely filing (i.e., within thirty days of the share issuance date) an election pursuant to Section 83(b) of the Code. In such event, the ordinary income recognized, if any, is measured as the difference between the amount paid for the stock, if any, and the fair market value of the stock on the date of such issuance, and the capital gain holding period commences on such date. The ordinary income recognized by an employee will be subject to tax withholding by the Company. Unless limited by Section 162(m), the Company is entitled to a deduction in the same amount as and at the time the employee recognizes ordinary income.

Cash Awards. Upon receipt of cash, the recipient will have taxable ordinary income, in the year of receipt, equal to the cash received. Any cash received will be subject to tax withholding by the Company. Unless limited by Section 162(m) of the Code, the Company will be entitled to tax deduction in the amount and at the time the recipient recognizes compensation income.

Accounting Treatment

Prior to the first quarter of fiscal year 2006, options granted to employees under the Stock Plan that have fixed exercise prices that are equal to or greater than the fair market value per share on the grant date and that have a fixed number of shares associated with the option will generally not result in any direct charge to the

Company's reported earnings under current accounting rules. However, the fair value of those options is required to be disclosed in the notes to the Company's financial statements, and the Company also must disclose, in the notes to its financial statements, the pro forma impact those options would have upon the Company's reported earnings and earnings per share were the fair value of those options at the time of grant treated as a compensation expense over the life of the option.

Beginning with the first quarter of fiscal year 2006 (assuming effectiveness of FAS 123R), the Company will generally be required to recognize compensation expense in an amount equal to the fair value on the date of grant of all stock options that are unvested as of or after such period. The fair value of an option will be based on the number of shares subject to the option that are expected to vest. The Company will use either Black-Scholes or a binomial valuation model to measure fair value of option grants. In addition, the Company will be required to recognize compensation expense for options as they vest, as adjusted for actual forfeitures that occur before vesting but not adjusted for any previously recognized compensation cost if an option lapses unexercised.

PROPOSAL NO. 3

AMENDMENT OF THE COMPANY S 2000 DIRECTORS STOCK OPTION PLAN

At the Annual Meeting, you are being asked to approve amendments to the 2000 Directors Stock Option Plan (the Directors Plan) to:

- increase the number of shares of common stock issuable under the Directors Plan by an additional 425,000 shares, to an aggregate of 925,000 shares (approximately 1.7% of the outstanding shares as of April 25, 2005);
- increase the number of option shares issued to nonemployee directors annually in connection with their continued service on the Board (from 12,000 shares) to 20,000 shares; and
- modify the vesting of such annual option grants so that such shares vest completely on the day before the first anniversary of the date of grant.

The Directors Plan was adopted by the Board of Directors in March 31, 2000 and it became effective on September 27, 2000 after approval of the stockholders. In April 2005, the Board approved amendments of the Directors Plan to make the changes described above, subject to stockholder approval.

The Board adopted these amendments because it believes that having additional shares available to issue to nonemployee directors under the Directors Plan and increasing the size of the automatic option grants made under the Directors Plan are necessary to attract and retain nonemployee directors, and rewarding the committee members and committee chairpersons is appropriate in light of the equity compensation to directors provided by comparable companies to us, the increased workload and responsibilities that such individuals face in connection with their service on our Board.

Recommendation of the Board:

THE BOARD RECOMMENDS A VOTE *FOR*

AMENDMENT OF THE 2000 DIRECTORS STOCK OPTION PLAN.

General Plan Background

As of April 25, 2005, options (net of expired or canceled options or options retained by the Company to satisfy the exercise price of an option or any withholding taxes due with respect to the exercise of an option) covering an aggregate of 193,000 shares of our common stock had been granted under the Directors Plan. As of April 25, 2005, 307,000 shares of our common stock (plus any shares that might in the future be returned to the Directors Plan as a result of cancellations or expiration of options or as a result of being retained by the Company to pay the exercise price or withholding taxes due upon exercise of options) remain available for future grant under the Directors Plan.

Summary of the Directors' Plan

A copy of the Directors' Plan is attached to this proxy statement as Appendix B. The following description of the Directors' Plan is a summary and so is qualified by reference to the complete text of the Directors' Plan. Except as otherwise noted, this summary reflects the amendments proposed above.

General

The purpose of the Directors' Plan is to enhance the long-term stockholders' value of the Company by attracting and retaining the best available personnel for service as directors of the Company, providing additional incentive to the nonemployee directors of the Company to serve as directors, and encouraging their continued service on the Board. Stock options granted under the Directors' Plan will be nonstatutory stock options which are options that are not intended to qualify as incentive stock options under Section 422 of the Code.

Administration. The Directors' Plan will be administered by the Board.

Eligibility. Non-statutory stock options may be granted under the Directors' Plan to nonemployee directors of the Company. All option grants under the Directors' Plan are automatic and nondiscretionary. As of April 25, 2005, the Company had five nonemployee directors who are eligible to participate in the Directors' Plan.

As of April 25, 2005, none of shares of the Company's common stock had been issued upon exercise of options granted under the Directors' Plan, options to purchase 193,000 shares of the Company's common stock were outstanding under the Directors' Plan and 307,000 shares of the Company's common stock remained available for future grant. If this Proposal No. 3 is approved, 732,000 shares of the Company's common stock will remain available for future grant under the Directors' Plan.

Options

Automatic Option Grants. Under the Directors' Plan, each person who becomes a nonemployee director is automatically granted an option (the "Initial Option") to purchase 30,000 shares of our common stock (as adjusted for stock splits, stock dividends, reclassifications and like transactions) on the date on which such person first becomes a nonemployee director. Each nonemployee director (including a nonemployee director who did not receive a Initial Option) is automatically granted an option (the "Annual Option") to purchase 20,000 shares of our common stock (as adjusted for stock splits, stock dividends, reclassifications and like transactions) on the date of each annual meeting of the stockholders of the Company (commencing with the Annual Meeting for 2006), provided that, the nonemployee director shall have served on the Board for at least six months prior to date of such annual meeting of stockholders.

In the event that a grant would cause the number of shares subject to outstanding options plus the number of shares previously purchased upon exercise of options to exceed the number of shares available for issuance under the Directors' Plan, then each such automatic option grant shall be for that number of shares determined by multiplying the number of shares subject to each such automatic option grant as of such date by a fraction equal to the total number of shares remaining available for grant as of such date by the aggregate number of shares subject to automatic option grants due as of such date. Any further grants shall then be deferred until such time, if any, as additional shares become available for grant under the Directors' Plan through action of the stockholders to increase the number of shares which may be issued under the Directors' Plan or through cancellation or expiration of options previously granted under the Directors' Plan.

Exercise Price. The exercise price of all stock options granted under the Directors' Plan will be equal to the fair market value of our common stock on the date of grant of the option. The fair market value of our common stock is generally the closing sales price as reported in the Wall Street Journal on the date of grant.

Vesting. Each Initial Option shall vest and become exercisable as to one third of the shares underlying the option on each anniversary of its date of grant so that the option shall be fully vested and exercisable on the third anniversary of its date of grant. Each Annual Option shall vest and become exercisable as to 100% of the shares underlying the option on the day before the day of the annual meeting of the year after grant.

Form of Consideration. The means of payment for shares issued on exercise of an option are specified in each option agreement. The Directors' Plan permits payment to be made by cash, check, other shares of our common stock (with some restrictions) or any other method of payment as shall be permitted under applicable corporate law.

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Term of Option. The term of an option may be no more than ten years from the date of grant. No option may be exercised after the expiration of its term.

Termination of Options. Generally, if an optionee's services to the Company as a director terminate other than for death or disability, vested options as of the last day of service will remain exercisable for a period of

ninety days following the optionee's termination or if earlier, the expiration of the term of such option. Unless otherwise provided for in the option agreement, if an optionee dies or becomes totally and permanently disabled while a director (or with respect to death, within three months after termination as a director), the optionee's vested options as of the last day of service shall be exercisable for twelve months following the optionee's death or termination as a result of disability, or if earlier, the expiration of the term of such option.

If our Chief Executive Officer or his or her designee reasonably believes that an optionee has committed an act of misconduct, he may suspend the optionee's right to exercise any option pending a determination by the Board (excluding the director accused of such misconduct). If the Board (excluding the director accused of such misconduct) determines that an optionee has committed an act of embezzlement, fraud, dishonesty, nonpayment of an obligation owed to the Company, breach of fiduciary duty or deliberate disregard of the Company rules resulting in loss, damage or injury to the Company, or if an optionee makes an unauthorized disclosure of any Company trade secret or confidential information, engages in any conduct constituting unfair competition, induces any Company customer to breach a contract with the Company or induces any principal for whom the Company acts as agent to terminate such agency relationship, neither the optionee nor his or her estate shall be entitled to exercise any option. In making such determination, the Board (excluding the director accused of such misconduct) shall act fairly and shall give the optionee an opportunity to appear and present evidence on optionee's behalf at a hearing before the Board or a committee of the Board.

Nontransferability of Options. Unless otherwise determined by the Board, options granted under the Directors' Plan are not transferable other than by will or by the laws of descent or distribution or pursuant to a qualified domestic relations order (as defined by the Code or the rules thereunder) and may be exercised during the optionee's lifetime only by the optionee or its permitted transferee.

Adjustments on Changes in Capitalization, Merger or Change of Control

In the event of any stock dividend, stock split, reverse stock split, combination, reclassification or similar change to the capital structure of the Company without receipt of consideration by the Company, appropriate adjustments will be made to (i) the number of shares of common stock subject to the Directors' Plan, (ii) the number of shares of common stock that may be granted pursuant to options to any individual under the Directors' Plan, and (iii) the exercise price and number of shares of common stock under each outstanding option. Any such adjustments shall be made by the Board of Directors in its absolute discretion, and the decision of the Board shall be final, binding and conclusive.

In the event of a change of control as defined in the Directors' Plan, all outstanding options shall accelerate, vest in full and be fully exercisable immediately prior to the consummation of the transaction.

Amendment and Termination of the Directors' Plan

The Board may amend or terminate the Directors' Plan at any time the Board deems advisable. However, the Company shall obtain stockholder approval for any amendment to the Directors' Plan to the extent necessary and desirable to comply with applicable laws and Nasdaq National Market listing requirements. Generally, no such action by the Board or stockholders may alter or impair any option previously granted or Retainer previously determined under the Directors' Plan without the written consent of the optionee or eligible recipient of the Retainer. The Directors' Plan terminates in January 2010.

Federal Income Tax Consequences of Options under the Directors' 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 UNDER THE DIRECTORS' PLAN. IT DOES NOT DESCRIBE STATE OR OTHER TAX CONSEQUENCES OF THE ISSUANCE AND EXERCISE OF OPTIONS.

The grant of a nonstatutory option has no federal income tax effect on the optionee. Upon the exercise of a nonstatutory option, the optionee has taxable ordinary income (and unless limited by Section 162(m) of the Code, the Company is 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 nonstatutory option, the optionee recognizes either long-term or short-term capital gain or loss, depending on how long such stock was held, on any difference between the sale price and the exercise price, to the extent not recognized as taxable income on the date of exercise. The Company may allow nonstatutory options to be transferred subject to conditions and restrictions imposed by the Administrator; special tax rules may apply on such a transfer. In addition, special federal income tax rules apply if Company common stock is used to pay all or part of the option price.

Accounting of Options under the Directors' Plan

Prior to the first quarter of fiscal 2006, options granted to non-employee directors under the Directors' Plan that have fixed exercise prices that are equal to or greater than the fair market value per share on the grant date and that have a fixed number of shares associated with the option will generally not result in any direct charge to the Company's reported earnings under current accounting rules. However, the fair value of those options is required to be disclosed in the notes to the Company's financial statement, and the Company also must disclose, in the notes to its financial statements, the pro forma impact those options would have upon the Company's reported earnings and earnings per share were the fair value of those options at the time of grant treated as a compensation expense over the life of the option.

Beginning with the first quarter of fiscal 2006 (assuming effectiveness of FAS 123R), the Company will generally be required to recognize compensation expense in an amount equal to the fair market value on the date of grant of all stock options that are unvested as of or after such period. The fair value of an option will be based on the number of shares subject to the option that are expected to vest. The Company will use either Black-Scholes or a binomial valuation model to measure fair value of option grants. In addition, the Company will be required to recognize compensation expense for options as they vest, as adjusted for actual forfeitures that occur before vesting but not adjusted for any previously recognized compensation cost if an option lapses unexercised.

PROPOSAL NO. 4

RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee has recommended, and the Board has approved, the appointment of Ernst & Young LLP as our independent registered public accounting firm for fiscal 2005. Ernst & Young LLP has served as our independent registered public accounting firm since 1998. In the event that ratification of this selection of auditors is not approved by a majority of the shares of Common Stock voting at the Annual Meeting in person or by proxy, the Board will review its future selection of auditors.

A representative of Ernst & Young LLP is expected to be present at the Annual Meeting. This representative will have an opportunity to make a statement and will be available to respond to appropriate questions.

Recommendation of the Board:

THE BOARD OF DIRECTORS RECOMMENDS A VOTE *FOR*
RATIFICATION OF ERNST & YOUNG LLP AS THE COMPANY'S
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR FISCAL YEAR 2005

COMMON STOCK OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table presents information concerning the beneficial ownership of the shares of our common stock as of April 25, 2005 by:

- each person who is known by us to beneficially own more than 5% of our common stock;
- each of our directors;
- each of the named executive officers; and
- all of our directors and executive officers as a group.

The number and percentage of shares beneficially owned are based on 51,932,587 shares of common stock outstanding as of April 25, 2005. Beneficial ownership is determined under the rules and regulations of the Securities and Exchange Commission. Shares of common stock subject to options, warrants and conversion privileges that are currently exercisable or exercisable within 60 days of April 25, 2005 are deemed to be outstanding and beneficially owned by the person holding the options, warrants or convertible securities for the purpose of computing the number of shares beneficially owned and the percentage ownership of that person, but are not deemed to be outstanding for the purpose of computing the percentage ownership of any other person. Except as indicated in the footnotes to this table, and subject to applicable community property laws, these persons have sole voting and investment power with respect to all shares of our common stock shown as beneficially owned by them.

<u>Name and Address</u>	<u>Amount and Nature of Beneficial Ownership</u>	<u>Percent of Common Stock</u>
Holders of 5% or more of our common stock		
ALZA Corporation	6,600,000	12.7%
1900 Charleston Road		
Mountain View, CA 94043		
Zesiger Capital Group LLC(1)	4,559,300	8.8
320 Park Avenue, 30th Floor		
New York, NY 10022		
Brookside Capital Partners(2)	3,990,514	7.7
Two Copley Place		
Boston, MA 02116		

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Zazove Associates, LLC(3)	3,429,028	6.2
940 Southwood		
Incline Village, NV 89451		
Ironwood Capital Management, LLC(4)	2,608,875	5.0
21 Custom House Street		
Boston, MA 02110		
Directors and named executive officers		
Felix Theeuwes, D.Sc.(5)	2,030,951	3.9
Thomas A. Schreck (6)	3,022,450	5.8
James E. Brown, D.V.M.(7)	2,927,450	5.6
Timothy S. Nelson(8)	603,382	1.2
Steven C. Halladay Ph.D.(9)	87,741	*
Simon X. Benito	0	*
Michael D. Casey (10)	10,000	*

Name and Address	Amount	Percent
	and Nature of Beneficial Ownership	Percent of Common Stock
David R. Hoffmann(11)	38,000	*
Armand P. Neukermans, Ph.D.(12)	56,917	*
Jon S. Saxe(13)	42,000	*
All executive officers and directors as a group (15 persons)(14)	9,565,903	17.9

* Less than 1% of the outstanding shares of common stock. Except as otherwise noted, the address of each person listed in the table is c/o DURECT Corporation, 10240 Bubb Road, Cupertino, California 95014.

- (1) Based upon a Schedule 13G filed by Zesiger Capital Group LLC on February 14, 2005, in which Zesiger Capital Group LLC reported that Zesiger Capital Group LLC had sole voting power over 3,135,000 of such shares, shared voting power over none of such shares and sole dispositive power over 4,559,300 of such shares. Albert L. Zesiger, one of our former directors, is a principal of this company. Mr. Zesiger, in his capacity as a principal, has investment power with respect to these shares and voting power over 3,135,000 shares but disclaims beneficial ownership with respect hereto.
- (2) Represents 3,990,514 shares held by Brookside Capital Partners Fund, L.P. Matthew V. McPherron, one of our former directors, is a director of this partnership. Mr. McPherron disclaims beneficial ownership of these shares except to the extent of his pecuniary interest in these shares.
- (3) Based upon a Schedule 13G filed by Zazove Associates, LLC on February 15, 2005, in which Zazove Associates, LLC reported that Zazove Associates LLC had sole voting power over 3,429,028 of such shares (which includes 3,366,028 shares issuable upon the conversion of Durect Corporation Convertible Debentures Due June 15, 2008 held by Zazove Associates, LLC), shared voting power over none of such shares and sole dispositive power over 3,492,063 of such shares.
- (4) Based upon a Schedule 13G filed by Ironwood Capital Management, LLC on February 10, 2005, in which Ironwood Capital Management, LLC reported that Ironwood Capital Management, LLC had sole voting power over none of such shares, shared voting power over 1,769,275 of such shares, sole dispositive power over none of such shares and shared dispositive power over 2,608,875 of such shares.
- (5) Includes 11,000 shares held by Felix Theeuwes, and 1,790,001 shares held by the Felix and Marie-Therese Theeuwes Family Trust. Also includes 229,950 shares issuable upon exercise of options exercisable within 60 days of April 25, 2005.
- (6) Includes 1,865,000 shares held by Thomas A. Schreck, 840,000 shares held by Thomas A. Schreck, Trustee for Mason and Thomas Schreck, 100,000 shares held by Portola Capital Partners, L.P. for the benefit of Albert R. Schreck, Joel Schreck and the Thomas A. Schreck 1959 Trust. Also includes 217,450 shares issuable upon exercise of options exercisable within 60 days of April 25, 2005.
- (7) Includes 2,150,000 shares held by James E. Brown, and 560,000 shares held by the James & Karen Brown 1998 Trust U/A. Also includes 217,450 shares issuable upon exercise of options exercisable within 60 days of April 25, 2005.
- (8) Includes 389,325 shares held by Timothy S. Nelson and 25,000 shares held by Morgan Stanley Dean Witter, not in its individual capacity but solely as Custodian of the IRA of Timothy S. Nelson. Also includes 189,057 shares issuable upon exercise of options exercisable within 60 days of April 25, 2005.
- (9) Includes 790 shares held by Steven C. Halladay. Also includes 86,951 shares issuable upon exercise of options exercisable within 60 days of April 25, 2005.
- (10) Includes 10,000 shares issuable upon exercise of options exercisable within 60 days of April 25, 2005.
- (11) Includes 6,000 shares held by David R. Hoffmann and Judy A. Hoffmann in trust for the benefit of Alec D. Hoffman and Todd L. Hoffmann. Also includes 32,000 shares issuable upon exercise of options exercisable within 60 days of April 25, 2005.
- (12) Includes 1,250 shares held by Armand P. Neukermans. Also includes 55,667 shares issuable upon exercise of options exercisable within 60 days of April 25, 2005.
- (13) Includes 20,000 shares held by the Jon S. Saxe and Myrna G. Marshall 1997 Trust. Also includes 22,000 shares issuable upon exercise of options exercisable within 60 days of April 25, 2005.
- (14) Includes an aggregate of 1,466,800 shares issuable pursuant to the exercise of outstanding stock options exercisable within 60 days of April 25, 2005.

COMPENSATION OF EXECUTIVE OFFICERS

The following table shows the compensation paid by the Company for services rendered during the Company's three preceding fiscal years to (a) the person who served as our Chief Executive Officer during the fiscal year that ended December 31, 2004 and (b) the four other most highly compensated individuals who served as an executive officer during the fiscal year ended December 31, 2004 (the Named Executive Officers).

Summary Compensation Table

Name and Principal Position	Fiscal Year	Annual Compensation			Long-Term Compensation	
		Salary	Bonus	Other Annual Compensation	Restricted Stock Award(s) (\$)	Securities Underlying Options (#)
		(\$)	(\$)			
James E. Brown, D.V.M.						
President, Chief Executive Officer	2004	380,000				350,000
	2003	360,000				200,000
and Director	2002	320,000				
Felix Theeuwes, D.Sc.						
Chairman and Chief Scientific Officer	2004	390,000				350,000
	2003	380,000				225,000
	2002	350,000				
Thomas A. Schreck(1)						
Chief Financial Officer and Director	2004	360,000				225,000
	2003	340,000				200,000
	2002	300,000				
Timothy S. Nelson(2)						
Senior Vice President, Business and Commercial Development	2004	230,000	18,400	254		90,000
	2003	225,615		778		116,500
	2002	197,822	28,350			10,000
Steven C. Halladay, Ph.D.(3)						
Vice President, Clinical and Regulatory	2004	225,000	18,000			142,000
	2003	225,000				39,250
	2002	52,212				100,000

(1) Mr. Schreck is resigning as Chief Financial Officer and Director of the Company effective April 30, 2005.

(2) Mr. Nelson's employment with us ended in April 2005.

(3) Dr. Halladay joined the Company in September 2002. His annualized salary for 2002 was \$225,000.

OPTION GRANTS IN LAST FISCAL YEAR

The following table sets forth certain information for the year ended December 31, 2004 with respect to grants of stock options to each of the named executive officers. All options granted by us in 2004 were granted under our 2000 Stock Plan. These options have a term of 10 years. We granted options to purchase common stock equal to a total of 4,208,337 shares during 2004. Options were granted at an exercise price equal to the closing price of our common stock on the NASDAQ National Market on the date of grant. Potential realizable values are net of exercise price before taxes, and are based on the assumption that our common stock appreciates at the annual rate shown, compounded annually, from the date of grant until the expiration of the ten-year term.

These numbers are calculated based on Securities and Exchange Commission requirements and do not reflect our projection or estimate of future stock price growth. Unless the market price of the common stock appreciates over the option term, no value will be realized from the option grants made to executive officers. Actual gains, if any, on stock option exercises will be dependent on the future performance of our common stock. The assigned 5% and 10% rates of stock appreciation are based on the fair market value of our common stock at grant date.

Name	Individual Grants(1)		Exercise Price (\$/Share)	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
	Number of Securities Underlying Options Granted	Percent of Total Options Granted to Employees in Fiscal Year			5%	10%
	James E. Brown	225,000			5.3%	\$ 3.25
	125,000	3.0%	\$ 3.20	12/17/2014	\$ 251,558	\$ 637,497
Felix Theeuwes	225,000	5.3%	\$ 3.25	1/14/2014	\$ 459,879	\$ 1,165,424
	125,000	3.0%	\$ 3.20	12/17/2014	\$ 251,558	\$ 637,497
Thomas A. Schreck (2)	225,000	5.3%	\$ 3.25	1/14/2014	\$ 459,879	\$ 1,165,424
Timothy S. Nelson (3)	50,000	1.2%	\$ 2.51	2/27/2014	\$ 78,926	\$ 200,015
	40,000	1.0%	\$ 3.20	12/17/2014	\$ 80,499	\$ 203,999
Steven C. Halladay	75,000	1.8%	\$ 2.51	2/27/2014	\$ 118,389	\$ 300,022
	67,000	1.6%	\$ 3.20	12/17/2014	\$ 134,835	\$ 341,698

(1) No stock appreciation rights were granted to the named executive officers.

(2) Mr. Schreck is resigning as Chief Financial Officer and Director of the Company effective April 30, 2005.

(3) Mr. Nelson's employment with us ended in April 2005.

**AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR
AND FISCAL YEAR-END OPTION VALUES**

The following table provides certain information with respect to stock options exercised by the named executive officers during the last fiscal year that ended December 31, 2004. The value of in-the-money options is based on the fair market value of our common stock of \$3.28 per share as quoted on the Nasdaq Stock Market on December 31, 2004 and net of the option exercise price.

<u>Name</u>			Number of Securities	
			Underlying Unexercised	Value of Unexercised
	Shares	Value	Options at	In-the-money Options at
	Acquired On	Realized	December 31, 2004	December 31, 2004
	<u>Exercise (#)</u>	<u>(\$)</u>	<u>Exercisable/Unexercisable</u>	<u>Exercisable/Unexercisable</u>
James E. Brown			134,700/495,300	\$ 92,990/\$263,760
Felix Theeuwes			140,950/514,050	\$ 103,615/\$295,635
Thomas A. Schreck (1)			134,700/370,300	\$ 92,990/\$253,760
Timothy S. Nelson (2)			161,557/179,050	\$ 55,165/\$184,585
Steven C. Halladay			60,170/221,080	\$ 22,102/\$108,984

- (1) Mr. Schreck is resigning as Chief Financial Officer and Director of the Company effective April 30, 2005.
- (2) Mr. Nelson's employment with us ended in April 2005.

Options shown above were granted under the 2000 Stock Plan.

Equity Compensation Plan Information

The following table provides information as of December 31, 2004 with respect to the shares of our common stock that may be issued under our existing equity compensation plans.

<u>Plan Category</u>	Number of Securities
	to be Issued Upon
	Exercise of
	Outstanding Options,
	<u>Warrants and Rights</u>