

HOLLIS EDEN PHARMACEUTICALS INC /DE/  
Form DEF 14A  
April 27, 2007

## SCHEDULE 14A INFORMATION

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

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

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

## Hollis-Eden Pharmaceuticals, Inc.

(Name of Registrant as Specified In Its Charter)

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

Payment of Filing Fee (Check the appropriate box)

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

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6. Amount Previously Paid:

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7. Form, Schedule or Registration Statement No.:

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8. Filing Party:

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9. Date Filed:

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**HOLLIS-EDEN PHARMACEUTICALS, INC.**

**4435 Eastgate Mall, Suite 400**

**San Diego, CA 92121**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

**TO BE HELD ON JUNE 7, 2007**

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

**NOTICE IS HEREBY GIVEN** that the Annual Meeting of Stockholders of **HOLLIS-EDEN PHARMACEUTICALS, INC.**, a Delaware corporation (the Company), will be held on Thursday, June 7, 2007 at 2:00 p.m. local time at the La Jolla Hilton, 10950 North Torrey Pines Road, La Jolla, California 92037, for the following purposes:

1. To elect two Class I directors to hold office until the 2010 Annual Meeting of Stockholders.
2. To approve an increase to the total number of shares reserved for issuance under the Company's 2005 Equity Incentive Plan.
3. To approve an increase to the total number of shares reserved for issuance under the Company's 2005 Non-Employee Directors' Equity Incentive Plan.
4. To ratify the selection by the audit committee of the board of directors of BDO Seidman, LLP as the independent registered public accounting firm of the Company for its fiscal year ending December 31, 2007.
5. To transact such other business as may properly come before the meeting or any adjournment or postponement thereof.

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

The board of directors has fixed the close of business on April 13, 2007, as the record date for the determination of stockholders entitled to notice of and to vote at this annual meeting and at any adjournment or postponement thereof.

By Order of the Board of Directors

RICHARD B. HOLLIS

Chairman of the Board, President and Chief

Executive Officer

San Diego, California

April 27, 2007

**ALL STOCKHOLDERS ARE CORDIALLY INVITED TO ATTEND THE ANNUAL MEETING IN PERSON. WHETHER OR NOT YOU EXPECT TO ATTEND THE ANNUAL MEETING, PLEASE COMPLETE, DATE, SIGN AND RETURN THE ENCLOSED PROXY AS PROMPTLY AS POSSIBLE IN ORDER TO ENSURE YOUR REPRESENTATION AT THE ANNUAL MEETING. A RETURN ENVELOPE (WHICH IS POSTAGE PREPAID IF MAILED IN THE UNITED STATES) IS ENCLOSED FOR THAT**

**PURPOSE. EVEN IF YOU HAVE GIVEN YOUR PROXY, YOU MAY STILL VOTE IN PERSON IF YOU ATTEND THE ANNUAL MEETING. PLEASE NOTE, HOWEVER, THAT IF YOUR SHARES ARE HELD OF RECORD BY A BROKER, BANK OR OTHER NOMINEE AND YOU WISH TO VOTE AT THE ANNUAL MEETING, YOU MUST OBTAIN FROM THE RECORD HOLDER A PROXY ISSUED IN YOUR NAME.**

**HOLLIS-EDEN PHARMACEUTICALS, INC.**

**4435 Eastgate Mall, Suite 400**

**San Diego, CA 92121**

**PROXY STATEMENT**

**FOR THE 2007 ANNUAL MEETING OF STOCKHOLDERS**

**June 7, 2007**

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

**Why am I receiving these materials?**

We sent you this proxy statement and the enclosed proxy card because the board of directors of Hollis-Eden Pharmaceuticals, Inc. (sometimes referred to in this proxy statement as we, us, the Company or Hollis-Eden) is soliciting your proxy to vote at the 2007 annual meeting of stockholders. You are invited to attend the annual meeting to vote on the proposals described in this proxy statement. However, you do not need to attend the annual meeting to vote your shares. Instead, you may simply complete, sign and return the enclosed proxy card.

We intend to begin mailing this proxy statement and accompanying proxy card on or about May 4, 2007 to all stockholders of record entitled to vote at the annual meeting.

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

Only stockholders of record at the close of business on April 13, 2007 will be entitled to vote at the annual meeting. On this record date, there were 28,951,901 shares of our common stock outstanding and entitled to vote.

*Stockholder of Record: Shares Registered in Your Name*

If on April 13, 2007 your shares were registered directly in your name with our transfer agent, American Stock Transfer & Trust Company, then you are a stockholder of record. As a stockholder of record, you may vote in person at the annual meeting or vote by proxy. Whether or not you plan to attend the annual meeting, we urge you to fill out and return the enclosed proxy card to ensure your vote is counted.

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

If on April 13, 2007 your shares were held in an account at a brokerage firm, bank, dealer, or other similar organization, then you are the beneficial owner of shares held in street name and these proxy materials are being forwarded to you by that organization. The organization holding your account is considered the stockholder of record for purposes of voting at the annual meeting. As a beneficial owner, you have the right to direct your broker or other agent on how to vote the shares in your account. You are also invited to attend the annual meeting. However, since you are not the stockholder of record, you may not vote your shares in person at the meeting unless you request and obtain a valid proxy from your broker or other agent.

**What am I voting on?**

There are four matters scheduled for a vote:

Election of two Class I directors to hold office until the 2010 annual meeting of stockholders;

Approval of an increase to the total number of shares reserved for issuance under our 2005 Equity Incentive Plan;

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Approval of an increase to the total number of shares reserved for issuance under our 2005 Directors' Equity Incentive Plan; and

Ratification of the selection of BDO Seidman, LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2007.

**How do I vote?**

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

*Stockholder of Record: Shares Registered in Your Name*

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

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

To vote using the proxy card, simply complete, sign and date the enclosed proxy card and return it promptly in the envelope provided. If you return your signed proxy card to us before the annual meeting, we will vote your shares as you direct.

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

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

**How many votes do I have?**

On each matter to be voted upon, you have one vote for each share of common stock you own as of April 13, 2007, the record date for the determination of stockholders entitled to notice of and to vote at the annual meeting and at any adjournment or postponement thereof.

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

If you return a signed and dated proxy card without marking any voting selections, your shares will be voted For the election of all nominees for director, For the proposal to increase the total number of shares reserved for issuance under our 2005 Equity Incentive Plan; For the proposal to increase the total number of shares reserved for issuance under our 2005 Non-Employee Directors Equity Incentive Plan; and For the ratification of the selection of BDO Seidman, LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2007. If any other matter is properly presented at the annual meeting, your proxy (one of the individuals named on your proxy card) will vote your shares using his best judgment.

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

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

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

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

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

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

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

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

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

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

To be considered for inclusion in next year's proxy materials, your proposal must be submitted in writing by January 8, 2008, to our Secretary at 4435 Eastgate Mall, Suite 400, San Diego, California 92121. If you wish to submit a proposal that is not to be included in next year's proxy materials, your proposal generally must be submitted in writing to the same address no later than March 9, 2008 but no earlier than February 7, 2008.

**How are votes counted?**

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

If on April 13, 2007 your shares were held in an account at a brokerage firm, bank, dealer, or other similar organization, then you are the beneficial owner of shares held in street name and these proxy materials are being forwarded to you by that organization. The organization holding your account is considered the stockholder of record for purposes of voting at the annual meeting. As a beneficial owner, you have the right to direct your broker or other agent on how to vote the shares in your account. You are also invited to attend the annual meeting. However, since you are not the stockholder of record, you may not vote your shares in person at the meeting unless you request and obtain a valid proxy from your broker or other agent.

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

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

To be approved, Proposal No. 2, approval of an increase to the total number of shares reserved for issuance under our 2005 Equity Incentive Plan, must receive a For vote from the majority of shares present and entitled to vote either in person or by proxy. If you Abstain from voting, it will have the same effect as an Against vote.

To be approved, Proposal No. 3, approval of an increase to the total number of shares reserved for issuance under our 2005 Non-Employee Directors Equity Incentive Plan, must receive a For vote from the majority of shares present and entitled to vote either in person or by proxy. If you Abstain from voting, it will have the same effect as an Against vote.



To be approved, Proposal No. 4, the ratification of the selection of BDO Seidman, LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2007, must receive a For vote from the majority of shares present and entitled to vote either in person or by proxy. If you Abstain from voting, it will have the same effect as an Against vote. Broker non-votes will have no effect.

**What is the quorum requirement?**

A quorum of stockholders is necessary to hold a valid annual meeting. A quorum will be present if stockholders holding at least a majority of the outstanding shares are present at the annual meeting in person or represented by proxy. On the record date of April 13, 2007, there were 28,951,901 shares outstanding and entitled to vote.

Your shares will be counted towards the quorum only if you submit a valid proxy (or one is submitted on your behalf by your broker, bank or nominee) or if you vote in person at the meeting. Abstentions and broker non-votes will be counted towards the quorum requirement. If there is no quorum, the holders of a majority of the shares present at the meeting in person or represented by proxy may adjourn the meeting to another date.

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

Preliminary voting results will be announced at the annual meeting. Final voting results will be published in our quarterly report on Form 10-Q for the second quarter of 2007.

**Proposal 1**

**ELECTION OF DIRECTORS**

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

Our board of directors is presently composed of six members. Paul Bagley, who was a director in the class of directors whose term of office expires at the upcoming 2007 annual meeting, notified our board of directors of his resignation as a director effective February 28, 2007. Mr. Bagley's resignation created a vacancy on our board of directors that will not be filled by vote of our stockholders at the upcoming annual meeting. There are two other directors in the class whose term of office expires in 2007. The nominees for election to this class, Jerome Hauer and Marc Sarni, are current members of our board of directors, having been elected by the stockholders. If elected at the annual meeting, each of the nominees would serve until the 2010 annual meeting and until his successor is elected and has qualified, or until his earlier death, resignation or removal.

Directors are elected by a plurality of the votes present in person or represented by proxy and entitled to vote at the meeting. Proxies cannot be voted for a greater number of persons than the number of nominees named. In the event that any nominee should be unavailable for election as a result of an unexpected occurrence, such shares will be voted for the election of a substitute nominee as our board of directors may propose upon recommendation from our nominating and corporate governance committee.

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

**NOMINEES FOR ELECTION FOR A THREE-YEAR TERM EXPIRING AT THE 2010 ANNUAL MEETING**

*Jerome M. Hauer*

Mr. Hauer, age 55, has served as a member of our board of directors since June 2004. Mr. Hauer has served as chief executive officer at The Hauer Group, a consulting services firm, since March 2006. Mr. Hauer served as senior vice president and co-chair of the homeland security practice of Fleishman-Hillard Government Relations, a government relations service firm, from January 2005 to March 2006. Prior to joining Fleishman-Hillard, Mr. Hauer served as the director of Response to Disaster and Emergencies Institute and assistant professor at the George Washington University School of Public Health from November 2003 to December 2004. Mr. Hauer served as acting assistant secretary for public health emergency preparedness of the U.S. Department of Health and Human Services, or HHS, from June 2002 to November 2003 and as director of the office of public health preparedness of HHS from May 2002 to June 2002. He also served as managing director of the crisis and consequence management group at Kroll Associates, a risk consulting firm, from October 2000 to February 2002. Mr. Hauer served as the first director of the New York City Mayor's Office of Emergency Management under Mayor Rudolph Giuliani. He also served as the director of Emergency Medical Services and Emergency Management as well as director of the Department of Fire and Buildings for the State of Indiana under Governor Evan Bayh. Mr. Hauer serves on the board of directors of Emergent BioSolutions, Inc., a publicly held pharmaceutical company. Mr. Hauer previously served as a member of the Health Advisory Board of the Johns Hopkins School of Public Health and as a member of the National Academy of Science's Institute of Medicine's Committee to Evaluate the R&D Needs for Improving Clinical Medical Response to Chemical or Biological Terrorism Incidents. Mr. Hauer received an M.H.S. in public health from Johns Hopkins University School of Hygiene and Public Health and a B.A. in Psychology and History from New York University.

*Marc R. Sarni*

Mr. Sarni, age 48, has served as a member of our board of directors since June 2004. Mr. Sarni is a Principal at Cornerstone Investment, LLC and a Managing Director of NEW Holdings, LLC, companies engaged in the investment in, and development, brokerage and property management of, both residential and commercial real estate. Mr. Sarni worked as an investment banker at A.G. Edwards and Sons, Inc. for 17 years, and from 1997 until 2003, Mr. Sarni was the Managing Director responsible for establishing and managing the Healthcare Industry Group within the corporate finance department's Emerging Growth Sector. The Healthcare Industry Group of A.G. Edwards focused primarily on emerging growth medical technology, biotechnology, specialty pharmaceutical and healthcare services companies. Prior to joining A.G. Edwards, Mr. Sarni spent three years working as a Certified Public Accountant at PriceWaterhouse (now PricewaterhouseCoopers LLP). Mr. Sarni currently serves as a member of the Boards of Directors of Microtek Medical Holdings, Inc., a publicly held developer of infection and fluid control, safety, and other medical products directed at the healthcare industry, Cornerstone Investment, LLC, NEW Holdings, LLC, Howard Commercial Corp., and Managers for Ascension Health Ventures, the strategic health venture-investing subsidiary of Ascension Health, the nation's largest Catholic and not-for-profit healthcare system. Mr. Sarni graduated from the University of Missouri at Columbia with a BSBA degree in Accounting and from the University of Chicago with an M.B.A. in Finance.

**OUR BOARD OF DIRECTORS RECOMMENDS**

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

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

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

Dr. Merigan, age 73, became a scientific advisor and director of Hollis-Eden in March 1996. Dr. Merigan was George E. and Lucy Becker Professor of Medicine at Stanford University School of Medicine from 1980 to 2004. He continues to hold the chair as an active emeritus professor. Dr. Merigan has also been the Principal Investigator, NIAID Sponsored AIDS Clinical Trials Unit, from 1986 to the present, and has been Director of Stanford University's Center For AIDS Research from 1988 to the present. Dr. Merigan is a member of various medical and honorary societies, has lectured extensively within and outside the United States, and authored numerous books and articles and has chaired and edited symposia relating to infectious diseases, including anti-viral agents, HIV and other retroviruses, and AIDS. From 1990 to the present, Dr. Merigan has been Chairman, Editorial Board of *HIV: Advances in Research and Therapy*. He is also a member of the editorial boards of *Aids Research and Human Retroviruses* (since 1983), *International Journal of Anti-Microbial Agents* (since 1990), and *The Aids Reader* (since 1991), among others. He is a co-recipient of ten patents, which, among other things, relate to synthetic polynucleotides, modification of hepatitis B virus infection, treatment of HIV infection, purified cytomegalovirus protein and composition and treatment for herpes simplex. Dr. Merigan was Chair, Immunology AIDS Advisory Board, Bristol Myers Squibb Corporation from 1989 to 1995 and Chair, Scientific Advisory Board, Sequel Corp. from 1993 to 1996. In 1994, Stanford University School of Medicine honored him with the establishment of the Annual Thomas C. Merigan Jr. Endowed Lectureship in Infectious Diseases, and, in 1996, Dr. Merigan was elected Fellow, American Association for the Advancement of Science. From 1966 to 1992, Dr. Merigan was Head, Division of Infectious Diseases, at Stanford School of Medicine. Dr. Merigan received his B.A. from the University of California at Berkeley and his M.D. from the University of California at San Francisco.

*Brendan R. McDonnell*

Mr. McDonnell, age 44, has served as a member of our board of directors since August 1996. In 2003, Mr. McDonnell joined the law firm Kirkpatrick & Lockhart Preston Gates Ellis LLP as an equity partner and serves as Practice Group Leader. From 1997 to 2003, Mr. McDonnell was of counsel and then a partner at Tonkon Torp LLP, a Northwest based law firm. Mr. McDonnell specializes in representing both private and public emerging growth companies, with focus on the high technology industry. Mr. McDonnell is the past Chair

of the Business Section of the Oregon State Bar and spent two years as an adjunct professor at the Northwestern School of Law of Lewis and Clark College. Mr. McDonnell holds a B.S. in accounting from Loyola Marymount University and a J.D. from the University of California at Davis. He is a member of the California, Oregon and Washington State Bar Associations.

**DIRECTORS CONTINUING IN OFFICE UNTIL THE 2009 ANNUAL MEETING**

*Richard B. Hollis*

Mr. Hollis, age 54, founded Hollis-Eden in August 1994, and currently serves as our Chairman, President and Chief Executive Officer. Mr. Hollis has over 29 years experience in the health care industry, has a proven track record of launching and marketing important new medical products, and a distinguished career of managing the growth and operations of companies in a variety of senior management positions. Mr. Hollis began his career in product sales with Baxter Travenol (today Baxter International), where he specialized in launching and marketing parenteral, enteral and intravenous solutions to hospitals and nursing homes. Mr. Hollis next joined Imed Corporation, a world leader in drug delivery devices in the 1980s, where he rapidly advanced through numerous sales, marketing and managerial positions. When Imed was acquired by Warner Lambert (today part of Pfizer Inc.), Mr. Hollis was one of two Division Managers at Imed. After leaving Warner Lambert, Mr. Hollis joined Genentech, Inc. as Western Business Unit Manager as the Bay Area biotechnology revolution was unfolding. At Genentech, Mr. Hollis was instrumental in the launch of two blockbuster pharmaceutical products Protropin (human growth hormone) and Activase (tissue plasminogen activator). Following those successful product launches, Mr. Hollis joined Instromedix, a manufacturer of cardiac monitoring devices, as General Manager and Vice President of Marketing and Sales, and subsequently was named Chief Operating Officer of Bioject Medical, a manufacturer of needleless drug delivery devices. In 1994 he acted on his vision of founding a new pharmaceutical company, Hollis-Eden, which he initially self-funded and successfully brought public in 1997. Mr. Hollis received his B.A. in Psychology from San Francisco State University after studying the humanities while attending St. Mary's College.

*Salvatore J. Zizza*

Mr. Zizza, age 61, has served as a member of our board of directors since March 1997. Mr. Zizza was elected as Lead Independent Director of our board of directors in March 2006. He served as Chairman of our board, President and Treasurer of Initial Acquisition Corp., from 1992 until March 1997, at which time Initial Acquisition Corp. merged with the Company. Mr. Zizza is presently Chairman of Hallmark Electrical Supplies Corp. Mr. Zizza is also Chairman of Bethlehem Advanced Materials. Mr. Zizza was President and Chief Financial Officer of NICO Construction Company, Inc. until 1985, when NICO merged with The LVI Group, Inc. Prior to joining The LVI Group, Inc., Mr. Zizza was an independent financial consultant and had been a lending officer for Chemical Bank. Mr. Zizza's current and former directorships include: The Gabelli Equity Trust (NYSE), The Gabelli Asset Fund, The Gabelli Growth Fund, The Gabelli Convertible and Income Securities Fund, The Gabelli Utility Trust Fund (NYSE), The Gabelli Global Multimedia Trust (NYSE), The Gabelli Equity Series Fund, The Gabelli Dividend and Income Trust, The Gabelli Gold Fund, the Gabelli International Growth Fund, The Gabelli Global Gold Natural Resources, Westwood Funds, Earl Scheib Inc (NASDAQ), Bion Environmental Technology Inc. and St. David's School. Mr. Zizza received a B.S. in Political Science and an M.B.A. from St. John's University.

**INDEPENDENCE OF THE BOARD OF DIRECTORS**

As required under The Nasdaq Global Market (Nasdaq) listing standards, a majority of the members of a listed company's board of directors must qualify as independent, as affirmatively determined by the company's board of directors. After review of all relevant transactions and relationships between each director, or any of his or her family members, and us, our senior management and our independent registered public accounting firm, our board affirmatively has determined that Messrs. Sarni, Zizza, Merigan, Hauer and McDonnell are independent directors within the meaning of the Nasdaq listing standards.

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

During 2006, our board of directors held six meetings. Each board member attended at least 75% of the aggregate number of meetings of our board and of the committees on which he served, held during the period for which he was a director or committee member, respectively, with the exception of Mr. Bagley who attended five of the eight meetings of our Compensation Committee during 2006.

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

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

**Nominating and Corporate Governance Committee**

Our board of directors has adopted a Nominating and Corporate Governance Committee Charter, which can be found on our corporate website at [www.holliseden.com](http://www.holliseden.com). The Nominating and Corporate Governance Committee (Nominating Committee) is composed of three directors who are independent (as independence is currently defined in Rule 4200(a)(15) of the Nasdaq listing standards): Messrs. Zizza and Hauer and Dr Merigan. The Nominating Committee is responsible for identifying, reviewing and evaluating candidates to serve as our directors (consistent with criteria approved by our board), reviewing and evaluating incumbent directors, recommending to our board candidates for election to our board, assessing the performance of our board, and making recommendations to our board regarding the membership of the committees of our board. During 2006, the Nominating Committee consisted of: Messrs. Zizza, Hauer and McDonnell and held one meeting.

Our board of directors believes that candidates for director should have certain minimum qualifications, including: personal integrity and ethics; no interests that would materially impair his or her ability to exercise independent judgment and otherwise discharge his or her fiduciary duties; ability to represent all stockholders equally; achievement in one or more fields of business, professional, governmental, scientific or educational endeavor; sound judgment based on management or policy-making experience; general understanding of the major issues facing public companies of a similar size and operational scope as us; and ability to devote adequate time to our board and its committees. However, the Nominating Committee retains the right to modify these qualifications from time to time. Candidates for director nominees are reviewed in the context of the current composition of our board, our operating requirements and the long-term interests of our stockholders. In conducting this assessment, the Nominating Committee considers such factors as it deems appropriate given our current needs and the current needs of our board, to maintain a balance of knowledge, experience and capability. In the case of incumbent directors whose terms of office are set to expire, the Nominating Committee reviews such directors' overall service during their term, including the number of meetings attended, level of

participation, quality of performance, and any other relationships and transactions that might impair such directors' independence. In the case of new director candidates, the Nominating Committee will also determine whether the nominee must be independent for Nasdaq purposes, which determination is based upon applicable Nasdaq listing standards and applicable Securities and Exchange Commission rules and regulations. The Nominating Committee will then compile a list of potential candidates, using its own network of contacts, as well as recommendations from other board members and management. The Nominating Committee may also engage, if appropriate under the circumstances, a professional search firm to assist in identifying qualified candidates. The Nominating Committee will conduct any appropriate or necessary inquiries into the backgrounds and qualifications of possible candidates after considering the function and needs of our board. The Nominating Committee will meet to discuss and consider such candidates' qualifications and then select nominees for recommendation to our board by majority vote.

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

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

### **Compensation Committee**

The Compensation Committee makes recommendations to our board of directors concerning executive salaries and incentive compensation, administers our 2005 Equity Incentive Plan and 2005 Non-Employee Directors' Equity Incentive Plan and otherwise determines compensation levels and policies and performs such other functions regarding compensation as our board may delegate. Commencing this year, the Compensation Committee also began to review with management the Company's Compensation Discussion and Analysis section of this proxy statement and to consider whether to recommend that it be included in this proxy statements. The Compensation Committee is currently composed of three non-employee directors who are independent (as independence is currently defined in Rule 4200 (a)(15) of the Nasdaq listing standards): Messrs. McDonnell, Sarni and Zizza. During 2006, the Compensation Committee consisted of three non-employee directors who were independent: Mr. Bagley, a former director, and Messrs. McDonnell and Sarni and held eight meetings. The specific determinations of the Compensation Committee with respect to executive compensation for fiscal 2006 are described in greater detail in the Compensation Discussion and Analysis section of this proxy statement.

### **Compensation Committee Report**

The Compensation Committee has reviewed and discussed with management the Compensation Discussion and Analysis ( CD&A ) contained in this proxy statement. Based on this review and discussion, the Compensation Committee has recommended to the board of directors that the CD&A be included in this proxy statement and incorporated into our Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

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

Respectfully submitted by:

COMPENSATION COMMITTEE

Brendan R. McDonnell, Chairman

Marc R. Sarni

Salvatore J. Zizza

### **COMPENSATION COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION**

No interlocking relationship existed during 2006 or currently exists between any member of the Compensation Committee and any member of any other company s board of directors or compensation committee.

### **Audit Committee**

The Audit Committee oversees our corporate accounting and financial reporting process. For this purpose, the Audit Committee performs several functions. The Audit Committee evaluates the performance and assesses the qualifications of the independent registered public accounting firm; determines the engagement of the independent registered public accounting firm; determines whether to retain or terminate the existing independent registered public accounting firm or to appoint and engage a new independent registered public accounting firm; reviews and approves the retention of the independent registered public accounting firm to perform any proposed non-permissible audit services; and monitors the rotation of partners of the independent registered public accounting firm on our engagement team as required by law. The Audit Committee is also responsible for the review, approval and monitoring of transactions involving the company and related persons (directors and executive officers or their immediate family members, or stockholders owning five percent or greater of the company s outstanding stock) that meet the minimum threshold for disclosure in the proxy statement under the relevant Securities and Exchange Commission rules and regulations (generally, transactions involving amounts exceeding \$120,000 in which a related person has a direct or indirect material interest) The Audit Committee meets and reviews with management and the independent registered public accounting firm: the quarterly financial statements and disclosures prior to the filing of our Quarterly Reports on Form 10-Q; the financial statements and disclosures to be included in our Annual Report on Form 10-K; our policies with respect to risk assessment and risk management; our internal controls; and the results of the annual audit. The Audit Committee is composed of three directors and operates under a written charter adopted by our board of directors. Our board of directors reviews and assesses the adequacy of the Audit Committee s written charter on an annual basis in light of applicable Nasdaq and Securities and Exchange Commission rules and regulations. The current members of the Audit Committee are Messrs. McDonnell, Sarni and Zizza. During 2006, the Audit Committee consisted of three non-employee directors who were independent: Mr. Bagley, a former director, and Messrs. Sarni and Zizza and held six meetings. Our board of directors also annually reviews the definition of independence under the Nasdaq listing standards and Securities and Exchange Commission rules and regulations for Audit Committee members and has determined that all members of our Audit Committee are independent (as independence is currently defined in Rule 4350(d)(2)(A)(i) and (ii) of the Nasdaq listing standards and

Section 10A of the Securities Exchange Act of 1934, as amended). Each member of the Audit Committee is financially literate, knowledgeable and qualified to review financial statements. The Audit Committee Financial Expert designated by our board (as that term is defined in the rules and regulations established by the Securities and Exchange Commission) is Mr. Zizza. Our board of directors made a qualitative assessment of Mr. Zizza's level of knowledge and experience based on a number of factors, including his formal education and experience as a chief financial officer.



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

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

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

Our independent registered public accounting firm discussed with the Audit Committee the matters required to be discussed by Statement on Auditing Standards No. 61. Our independent registered public accounting firm also provided to the Audit Committee the written disclosures and the letter required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees), and the Audit Committee discussed with the independent registered public accounting firm that firm's independence.

Based on the Audit Committee's discussion with management and the independent registered public accounting firm as well as the Audit Committee's review of the representation of management and the report of the independent registered public accounting firm to the Audit Committee, the Audit Committee recommended that our board of directors include the audited financial statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 filed with the Securities and Exchange Commission.

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

Respectfully submitted by:

AUDIT COMMITTEE

Marc R. Sarni, Chairman

Brendan McDonnell

Salvatore J. Zizza

**STOCKHOLDER COMMUNICATIONS WITH OUR BOARD OF DIRECTORS**

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

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

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

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



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

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

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

Communications that contain offensive, vulgar or abusive content; and

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

**CODE OF BUSINESS CONDUCT AND ETHICS**

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

**Proposal 2**

**APPROVAL OF AN INCREASE TO THE NUMBER OF SHARES RESERVED**

**FOR ISSUANCE UNDER THE 2005 EQUITY INCENTIVE PLAN**

On April 27, 2005, our board of directors adopted the Hollis-Eden Pharmaceuticals, Inc. 2005 Equity Incentive Plan (the "2005 Equity Plan"). Our stockholders approved the 2005 Equity Plan in June 2005. The 2005 Equity Plan is an amendment and restatement of Hollis-Eden Pharmaceuticals' 1997 Incentive Stock Option Plan (the "1997 Option Plan"). Options granted under the 1997 Option Plan prior to its amendment and restatement are subject to the terms and conditions as set forth in the agreements evidencing such options and the terms of the 1997 Option Plan except that our board may elect to extend one or more of the features of the 2005 Equity Plan to stock awards granted under the 1997 Option Plan. The approval of the adoption of the 2005 Equity Plan increased the number of shares of our common stock reserved for issuance beyond those reserved for issuance under the 1997 Option Plan by 350,000 shares for a total of 5,500,000 reserved shares. In December 2005, our board amended the 2005 Equity Plan to reserve an additional 100,000 shares to be used only for the grant of stock awards to persons not previously employed by us, or following a bona fide period of non-employment, as an inducement material to those persons entering into employment with us within the meaning of Rule 4350(i)(1)(A)(iv) of the Nasdaq Marketplace Rules, and to provide that any such inducement awards must be granted either by a majority of our independent directors or a committee comprised of a majority of independent directors. On March 18, 2006, our board of directors amended and restated the 2005 Equity Plan to reserve an additional 500,000 shares for issuance under the 2005 Equity Plan which was subsequently approved by our stockholders in June 2006. On April 24, 2007, our board of directors approved the amendment to the 2005 Equity Plan to reserve an additional 1,500,000 shares for issuance, subject to approval by our stockholders at this annual meeting.

This Proposal 2 seeks an increase in the number of shares that may be issued under the 2005 Equity Plan by 1,500,000 shares. The additional 1,500,000 shares will increase the total shares of common stock reserved for issuance under the 2005 Equity Plan to an aggregate of 7,600,000. At March 31, 2007, options (net of cancelled, forfeited and exercised options) covering an aggregate of 5,550,361 shares had been granted under the 2005 Equity Plan and the 1997 Option Plan, and 366,402 shares (plus any shares that might in the future be returned to the 2005 Equity Plan and the 1997 Option Plan as a result of cancellations or expiration of options) remained available for future grant under the 2005 Equity Plan.

Approval of the increase of the total number of the shares of common stock reserved for issuance under the 2005 Equity Plan will allow us to continue to grant stock options and other awards at levels determined appropriate by our board of directors. Since its inception, the Company has utilized stock options as an important long-term incentive and as a component of total employee compensation.

Due to the significant decline in our stock price since the Fall of 2003 as a result of continued, unexpected governmental delays in the procurement process for securing a potential contract under Project Bioshield for our product candidate NEUMUNE® and the subsequent cancellation in March 2007 by the Department of Health and Human Services of its solicitation for medical countermeasures to treat the effects of acute radiation syndrome, this Proposal 2 is critically important to the Company's ability to continue to offer stock options to our employees and officers as an incentive and retention tool.

As a result of this decline in our stock price, all of our employees hold options with exercise prices significantly higher than the current market price of our common stock. As of March 31, 2007, the weighted average per share exercise price of the Company's currently outstanding stock options was \$8.91, significantly higher than the closing price of our common stock on March 31, 2007 of \$2.53 per share as reported on The Nasdaq Global Market. In fact, as of March 31, 2007, approximately 97% of the Company's currently outstanding stock options were out-of-the-money. In addition, a great number of these stock options have been out-of-the-money for an extended period of time. We believe that these out-of-the-money options are no longer effective as performance and retention incentives, and that to enhance long-term stockholder value we need to

maintain competitive employee compensation and incentive programs. An equity stake in the success of the Company is a critical component of these programs. Our Company's success depends on the continued service of the Company's key scientific, technical, sales, marketing and executive personnel, and our ability to identify, hire and retain qualified personnel. Because of the importance of stock options to the Company's continued success, our board of directors strongly supports this Proposal 2. If this Proposal 2 is not approved, the Company may not be able to implement adequate alternative long-term retention and incentive programs and stockholders should understand that the Company may be unable to retain existing personnel or identify or hire additional personnel which may negatively affect our ability to meet our needs for highly qualified personnel and materially and adversely affect our corporate goals, business and results of operations.

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

**OUR BOARD OF DIRECTORS RECOMMENDS**

**A VOTE IN FAVOR OF PROPOSAL 2.**

The following is a summary of the principal features of the 2005 Equity Plan. This summary is subject to, and qualified in its entirety by, the full text of the 2005 Equity Plan, a copy of which, as proposed to be amended, is attached as Appendix A to this proxy statement.

**General**

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

**Purpose**

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

**Administration**

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

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

### **Eligibility**

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

No incentive stock option may be granted under the 2005 Equity Plan to any person who, at the time of the grant, owns (or is deemed to own) stock possessing more than 10% of the total combined voting power of Hollis-Eden or its affiliates, unless the exercise price of such option is at least 110% of the fair market value of the stock subject to the option on the date of grant and the term of the option does not exceed five years from the date of grant. In addition, the aggregate fair market value, determined on the date of grant, of the shares of common stock with respect to which incentive stock options are exercisable for the first time by a participant during any calendar year (under the 2005 Equity Plan and any other plans of Hollis-Eden and its affiliates) may not exceed \$100,000.

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

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

Subject to stockholder approval of this Proposal 2 at the annual meeting, an aggregate of 7,600,000 shares of common stock are reserved for issuance under the 2005 Equity Plan, which includes 5,150,000 shares of common stock previously reserved for issuance under the 1997 Option Plan, 350,000 shares approved by our stockholders at the 2005 annual meeting of stockholders, 100,000 shares ( **inducement shares** ) separately reserved for issuance as **inducement awards** , 500,000 shares approved by our stockholders at the 2006 annual meeting of stockholders, plus an additional 1,500,000 shares. If a stock award granted under either the 2005 Equity Plan or the 1997 Option Plan expires or otherwise terminates without being exercised in full, or if any shares of common stock issued pursuant to a stock award are forfeited to or repurchased by Hollis-Eden, including, but not limited to, any repurchase or forfeiture caused by the failure to meet a contingency or condition required for the vesting of such shares, then the shares of common stock not issued under such stock award, or forfeited to or repurchased by Hollis-Eden shall revert to and again become available for issuance under the 2005 Equity Plan. If any shares subject to a stock award are not delivered to a participant because such shares are withheld for the payment of taxes or the stock award is exercised through a reduction of shares subject to the stock award (i.e., **net exercised** ), the number of shares that are not delivered shall remain available for issuance under the 2005 Equity Plan. If the exercise price of any stock award is satisfied by tendering shares of common stock held by the participant, then the number of shares so tendered shall remain available for issuance under the 2005 Equity Plan. Inducement shares that revert to, or remain available for subsequent issuance under, the 2005 Equity Plan may only be granted to the persons described below (see **Inducement Awards** ). The aggregate maximum number of shares of common stock that may be issued under the 2005 Equity Plan pursuant

to the exercise of incentive stock options is 7,500,000 shares plus the amount of any future increase in the number of shares that may be available for issuance under the 2005 Equity Plan. Inducement shares (see *Inducement Awards* below) may not be used to grant awards of incentive stock options.

As of April 13, 2007, the closing price of our common stock as reported on The Nasdaq Global Market was \$2.87 per share.

### **Terms of Options**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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



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

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

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

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

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

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

### **Performance-Based Stock Awards**

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

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

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

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

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

#### **Inducement Awards**

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

#### **Changes to Capital Structure**

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

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

Under the 2005 Equity Plan, unless otherwise provided in a written agreement between Hollis-Eden or any affiliate and the holder of the stock award, in the event of a corporate transaction (as defined in the 2005 Equity Plan), all outstanding stock awards under the 2005 Equity Plan may be assumed, continued or substituted for by any surviving or acquiring entity (or its parent company). If the surviving or acquiring entity (or its parent company) elects not to assume, continue or substitute for such stock awards, then (i) with respect to