

DURECT CORP  
Form DEFR14A  
April 29, 2004

**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**

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(Name of Registrant as Specified In Its Charter)

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

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Payment of Filing Fee (Check the appropriate box):

No fee required.

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(2) Aggregate number of securities to which transaction applies:

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

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(1) Amount Previously Paid:

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

(3) Filing Party:

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(4) Date Filed:

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## **DURECT CORPORATION**

**10240 Bubb Road**

**Cupertino, CA 95014**

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### **NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

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**TO BE HELD JUNE 3, 2004**

On Thursday, June 3, 2004, 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 6, 2004 can vote at this meeting or any adjournment that may take place. At the meeting we will:

- Elect the Class I directors of the Company's Board of Directors to serve until the Annual Meeting to be held in 2007.
- Ratify the appointment of Ernst & Young LLP as our independent auditors 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 two proposals outlined in this Proxy Statement.

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.

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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/ Thomas A. Schreck

Thomas A. Schreck

*Chief Financial Officer and Director*

Cupertino, California

April 29, 2004

**DURECT CORPORATION**

**10240 Bubb Road**

**Cupertino, CA 95014**

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**PROXY STATEMENT**

**FOR THE**

**2004 ANNUAL MEETING OF STOCKHOLDERS**

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**JUNE 3, 2004**

Our Board of Directors is soliciting proxies for the 2004 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 6, 2004, 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. 51,244,599 shares of common stock were outstanding on the record date.

Voting materials, which include this Proxy Statement, a proxy card and the 2004 Annual Report, will be mailed to stockholders on or about April 29, 2004.

**Our Annual Report on Form 10-K for the year ended December 31, 2003 is available on the Internet at our website at [www.direct.com](http://www.direct.com) in the investor relations section or through the SEC's electronic data system called EDGAR at [www.sec.gov](http://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@direct.com](mailto:info@direct.com).**

In this Proxy Statement:

- We, us, our and the Company refer to DURECT Corporation
- Annual Meeting or Meeting means our 2004 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 Thursday, June 3, 2004, 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 6, 2004, 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 6, 2004, 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 I directors to serve on our Board of Directors until our annual meeting of stockholders for the year ending December 31, 2007.
- The ratification of our appointment of Ernst & Young LLP as our independent auditors 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:

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- 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.

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 votes will be elected as directors and the ratification of the independent auditors 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**

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

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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 2004, which we will file with the SEC. You can get a copy on our website at [www.direct.com](http://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](http://www.sec.gov).

#### **Other Business**

We do not know of any business to be considered at the 2004 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 2005 Annual Meeting**

To have your proposal included in our proxy statement for the 2005 Annual Meeting, you must submit your proposal in writing before December 31, 2004 to Jean Liu, Senior Vice President and General Counsel, DURECT Corporation, 10240 Bubb Road, Cupertino, CA 95014.

If you submit a proposal for the 2005 Annual Meeting between February 5, 2005 and March 6, 2005, management may or may not, at their discretion, present the proposal at the meeting, and the proxies for the 2005 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 I directors whose terms expire at the Annual Meeting of Stockholders are Felix Theeuwes and Albert L. Zesiger; the Class II directors, whose terms expire at the 2005 Annual Meeting are David R. Hoffman, Jon S. Saxe and Thomas A. Schreck; and 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. 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. Felix Theeuwes and Albert L. Zesiger, our current Class I 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 I 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 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 3, 2004. The names of the nominees, their ages as of April 6, 2004, and certain other information about them are set forth below:

<u>Name</u>	<u>Age</u>	<u>Position</u>
Felix Theeuwes, D.Sc.	66	Chairman and Chief Scientific Officer
Albert L. Zesiger	75	Director

**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.

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*Albert L. Zesiger* has served as a Director since 1998. Mr. Zesiger is a Managing Director of Zesiger Capital Group LLC, an investment advisory firm, which Mr. Zesiger co-founded in October 1995. In 1968, Mr. Zesiger founded BEA Associates, Inc., an investment advisory firm, which in 1995 became wholly-owned by CS Holdings, the holding company for Credit Suisse Bank and CS First Boston. Mr. Zesiger also serves on the Board of Directors of Hayes Medical Inc. Mr. Zesiger holds a B.S. in Engineering from the Massachusetts Institute of Technology and an M.B.A. from the Harvard Graduate School of Business Administration.

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The names of the remaining directors, their ages as of April 6, 2004 and certain other information about them are set forth below:

Name	Age	Position
James E. Brown, D.V.M.	47	President, Chief Executive Officer and Director
Thomas A. Schreck	46	Chief Financial Officer and Director
Michael D. Casey (2)(3)	58	Director
David R. Hoffmann (1)(2)(3)	59	Director
Armand P. Neukermans, Ph.D.(1)(3)	63	Director
Jon S. Saxe (1)(2)	67	Director

- (1) Member of the Compensation Committee
- (2) Member of the Audit Committee
- (3) Member of the Nominating Committee

**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.

**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.

**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.

**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.

**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.

*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, Incyte Corporation, First Horizon Pharmaceuticals, SciClone, Questcor, InSite Vision, ID Biomedical Corporation and 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.

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.

*Independent Directors.* Each of our directors other than Messrs. Theeuwes, Brown and Schreck qualify as independent in accordance with the published listing requirements of NASDAQ as of June 3, 2004, 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 Committees. Each of the Board committees has a written charter approved by the Board. Copies of each charter are attached to this proxy as Appendices A, B and C respectively.

*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 auditors. In 2003, the Audit Committee held five meetings. The responsibilities and activities of the Audit Committee are described in greater detail in the Audit Committee Report and Appendix A: Audit Committee Charter. At the end of the last fiscal year, the Audit Committee was composed of the following directors: Jon S. Saxe, David R. Hoffmann and Armand P. Neukermans. In September 2003, Mr. Saxe was elected to the Audit Committee to replace Dr. Neukermans. In December 2003, Dr. Neukermans was again elected to the Audit Committee to replace Mr. Doyle, who resigned from our Board in November 2003. 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.

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 auditors may be retained to perform non-audit services. Our independent auditors provide 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 auditors 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, except for Mr. Hoffmann who currently serves as an Audit Committee member under the exceptional and limited circumstances exception of the current NASDAQ rules. Commencing June 3, 2004, the date of our annual meeting, Mr. Hoffmann will qualify as independent under the NASDAQ rules. 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 five



meetings in 2003 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 Armand P. Neukermans, David R. Hoffmann and Jon S. Saxe. In September 2003, Mr. Saxe was elected to the Compensation Committee to replace Mr. Doyle, and Dr. Neukermans was elected to replace James R. Butler who resigned from our Board in June 2003. 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, except for Mr. Hoffmann who currently serves as a Compensation Committee member under the exceptional and limited circumstances exception of the current NASDAQ rules. Commencing June 3, 2004, the date of our annual meeting, Mr. Hoffmann will qualify as independent under the NASDAQ rules.

*Nominating Committee.* The Nominating 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 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 Committee was established in April 2004 and therefore had no meetings in 2003. The members of the Nominating 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 Committee each qualify as independent under special standards established for members of nominating committees, except for Mr. Hoffmann who currently serves as a Nominating Committee member under the exceptional and limited circumstances exception of the current NASDAQ rules. Commencing June 3, 2004, the date of our annual meeting, Mr. Hoffmann will qualify as independent under the NASDAQ rules.

*Criteria for Board Membership.* In recommending candidates for appointment or re-election to the Board, the Nominating 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 Committee will consider written proposals from stockholders for nominees for director. Any such nominations should be submitted to the Nominating Committee c/o Jean Liu, Corporate 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 2005 Annual Meeting above.

*Process for Identifying and Evaluating Nominees.* The Nominating 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 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 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 Committee deems appropriate, a third-party search firm. The Nominating 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 Committee. Candidates meriting serious consideration will meet with all members of the Board. Based on this input, the Nominating 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, 2002 through December 31, 2003), the Board met 10 times. All directors are expected to attend each meeting of the Board and the committees on which he serves, and are also strongly encouraged to attend the Annual Stockholders Meeting. Each director, except Mr. Zesiger, attended at least 75% of all Board and applicable committee meetings during this time.

*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 Corporate Secretary. Stockholders can send communications by e-mail to [jean.liu@durect.com](mailto:jean.liu@durect.com), by fax to (408) 777-3577 or by mail to Jean Liu, Corporate 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 Corporate Secretary to forward such correspondence only to the intended recipients; however, the Board has also instructed the Corporate 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 is attached to this proxy as Appendix D. 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). A copy of the Company's Whistleblower Policy is attached to this proxy statement as Appendix E.

#### **Director Compensation**

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Each non-employee director is eligible to receive an attendance fee of \$1,000 for each Board meeting attended and \$500 for each telephonic Board meeting or committee meeting attended. Directors are also eligible to receive reimbursement of reasonable and customary travel expenses. In 2003, our non-employee directors

elected to waive their attendance fees until September 2003 when the Board reinstated the payment of attendance fees to non-employee directors. In March 2004, the Board amended the board compensation plan to provide that, in addition to the above described attendance fees, each non-employee director is eligible to receive a retainer fee equal to \$10,000 per year, paid on a quarterly basis, in consideration for his service on the Board.

All non-employee directors except Albert L. Zesiger 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. These options are for a ten-year term and become exercisable on the one-year anniversary of date of grant. 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.

Each of the non-employee directors named in this proxy statement other than Messrs. Casey and Zesiger will receive an additional option to purchase 12,000 shares of our common stock under the Directors' Plan on June 3, 2004, the date of our 2004 Annual Meeting.

Albert L. Zesiger has declined to receive any cash compensation for his service as director and declined to participate in our 2000 Directors' Stock Option Plan.

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**

**RATIFICATION OF APPOINTMENT OF INDEPENDENT AUDITORS**

The Audit Committee has recommended, and the Board has approved, the appointment of Ernst & Young LLP as our independent auditors. Ernst & Young LLP has served as our independent auditors 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* PROPOSAL 2.**

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**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 6, 2004 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 51,244,599 shares of common stock outstanding as of April 6, 2004. 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 6, 2004 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>
ALZA Corporation 1900 Charleston Road Mountain View, CA 94043	7,600,000	14.5%
RS Investment Management Co. LLC(1) 388 Market Street Suite 200 San Francisco, CA	5,836,200	11.4
Brookside Capital Partners(2) Two Copley Place Boston, MA 02116	3,990,514	7.8
Sagamore Hill Capital Management, L.P.(3) Two Greenwich Office Park Greenwich, CT 06831-5155	3,820,063	7.0

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Royce & Associates, LLC(4)	2,772,200	5.4
1414 Avenue of the Americas		
New York, NY 10019		
Biotech Growth N.V.(5)	2,754,957	5.4
De Ruyterkade 62		
Willemstad		
Curacao		
Netherland Antilles		
Albert L. Zesiger(6)	4,559,200	8.9
Felix Theeuwes, D.Sc.(7)	1,850,951	3.6
Thomas A. Schreck (8)	2,916,700	5.7
James E. Brown, D.V.M.(9)	2,844,700	5.5
Timothy S. Nelson(10)	543,511	1.1
Steven C. Halladay Ph.D.(11)	35,960	*
Michael D. Casey	0	*

Name and Address	Amount and Nature of Beneficial Ownership	Percent of Common Stock
David R. Hoffmann(12)	11,000	*
Armand P. Neukermans, Ph.D.(13)	41,584	*
Jon S. Saxe(14)	20,000	*
All executive officers and directors as a group (17 persons)(15)	13,763,832	26.3

\* 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 RS Investment Management Co. LLC and certain affiliated entities on February 18, 2004, in which RS Investment Management Co. LLC and certain affiliates reported that RS Investment Management Co. LLC and certain affiliates had sole voting power over none of such shares, shared voting power over 5,836,200 of such shares and sole dispositive power over 5,836,200 of such shares.
- (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 Sagamore Hill Capital Management, L.P. and certain affiliated entities on February 14, 2004, in which Sagamore Hill Capital Management, L.P. and certain affiliates reported that Sagamore Hill Capital Management, L.P. and certain affiliates had sole voting power over 3,820,063 of such shares, shared voting power over none of such shares and sole dispositive power over 3,820,063 of such shares.
- (4) Based upon a Schedule 13G filed by Royce & Associates, LLC on February 11, 2004, in which Royce & Associates, LLC reported that Royce & Associates, LLC had sole voting power over 2,772,200 of such shares, shared voting power over none of such shares and sole dispositive power over 2,772,200 of such shares.
- (5) Includes 500,000 shares held by Medgrowth N.V. Biotech Growth N.V. is a fully-owned subsidiary of BB Biotech A.G. Dr. Ernst Thomke shares voting and investment power over the shares held by Biotech Growth and disclaims beneficial ownership of such shares.
- (6) Includes 230,000 shares held by Albert L. Zesiger and 120,000 shares held by Barrie Ramsay Zesiger. Also includes an aggregate of 4,209,200 shares of common stock held in accounts managed for various parties by Zesiger Capital Group LLC, an investment advisor, for which Albert L. Zesiger is a principal. Mr. Zesiger, in his capacity as a principal, has investment power with respect to these shares and voting power over 3,165,000 shares but disclaims beneficial ownership with respect hereto.
- (7) Includes 11,000 shares held by Felix Theeuwes, and 1,719,001 shares held by the Felix and Marie-Therese Theeuwes Family Trust. Also includes 120,950 shares issuable upon exercise of options exercisable within 60 days of April 6, 2004.
- (8) Includes 1,862,000 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 114,700 shares issuable upon exercise of options exercisable within 60 days of April 6, 2004.
- (9) Includes 2,170,000 shares held by James E. Brown, and 560,000 shares held by the James & Karen Brown 1998 Trust U/A. Also includes 114,700 shares issuable upon exercise of options exercisable within 60 days of April 6, 2004.
- (10) Includes 387,980 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 130,531 shares issuable upon exercise of options exercisable within 60 days of April 6, 2004.
- (11) Includes 790 shares held by Steven C. Halladay. Also includes 35,170 shares issuable upon exercise of options exercisable within 60 days of April 6, 2004.
- (12) Includes 1,000 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 10,000 shares issuable upon exercise of options exercisable within 60 days of April 6, 2004.
- (13) Includes 40,334 shares issuable upon exercise of options exercisable within 60 days of April 6, 2004.
- (14) Represents 20,000 shares held by the Jon S. Saxe and Myrna G. Marshall 1997 Trust.
- (15) Includes an aggregate of 993,580 shares issuable pursuant to the exercise of outstanding stock options.

**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, 2003 and (b) the four other most highly compensated individuals who served as an executive officer during the fiscal year ended December 31, 2003 (the Named Executive Officers).

**Summary Compensation Table**

<b><u>Name and Principal Position</u></b>	<b><u>Fiscal Year</u></b>	<b><u>Annual Compensation</u></b>
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