

AMERICAN SHARED HOSPITAL SERVICES

Form DEF 14A

April 30, 2010

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**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**

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 Rule 14a-11(c) or Rule 14a-12

American Shared Hospital Services

(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

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(1) Title of each class of securities to which transaction applies:

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(1) Amount previously paid:

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**AMERICAN SHARED HOSPITAL SERVICES  
Four Embarcadero Center, Suite 3700  
San Francisco, California 94111**

**NOTICE OF 2010 ANNUAL MEETING OF SHAREHOLDERS  
To be held on June 2, 2010**

TO THE SHAREHOLDERS OF AMERICAN SHARED HOSPITAL SERVICES:

NOTICE IS HEREBY GIVEN that, pursuant to a call of the Board of Directors, the 2010 Annual Meeting of Shareholders (the Meeting ) of American Shared Hospital Services, a California corporation (the Company ), will be held in the East Trianon Suite of The Carlyle Hotel, 35 East 76th Street, New York, NY at 10:00 a.m. Eastern Daylight Time, on Wednesday, June 2, 2010 to consider and to act upon the following matters, all as set forth in the Proxy Statement.

1. ELECTION OF DIRECTORS. To elect the following five nominees to the Board of Directors to serve until the next Annual Meeting of Shareholders and until their successors are elected and have qualified:

Ernest A. Bates, M.D.  
Olin C. Robison  
Stanley S. Trotman, Jr.

John F. Ruffle  
Raymond C. Stachowiak

2. 2006 STOCK INCENTIVE PLAN. To approve the amendment and restatement of the 2006 Stock Incentive Plan.

3. RATIFICATION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM. To ratify the appointment of Moss Adams LLP as the Company s Independent Registered Public Accounting Firm for the year ending December 31, 2010.

4. OTHER BUSINESS. To transact such other business and to consider and take action upon any and all matters that may properly come before the Annual Meeting and any and all adjournments thereof.

The Board of Directors knows of no matters, other than those set forth in paragraphs (1), (2) and (3) above, that will be presented for consideration at the Meeting.

The Board of Directors has fixed the close of business on April 23, 2010 as the Record Date for the determination of shareholders entitled to vote at the Meeting.

WHETHER OR NOT YOU EXPECT TO ATTEND THE MEETING IN PERSON, PLEASE DATE, SIGN AND MAIL THE ENCLOSED PROXY IN THE ENVELOPE PROVIDED AS PROMPTLY AS POSSIBLE. THE PROXY IS REVOCABLE AND WILL NOT AFFECT YOUR RIGHT TO VOTE IN PERSON, IF YOU ATTEND THE MEETING. IN ORDER TO FACILITATE THE PROVISION OF ADEQUATE ACCOMMODATIONS, PLEASE INDICATE ON THE PROXY WHETHER YOU PLAN TO ATTEND THE MEETING IN PERSON.

By Order of the Board of Directors

Willie R. Barnes

*Corporate Secretary*

Dated: April 30, 2010  
San Francisco, California

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**AMERICAN SHARED HOSPITAL SERVICES  
Four Embarcadero Center, Suite 3700  
San Francisco, California 94111**

**PROXY STATEMENT  
2010 ANNUAL MEETING OF SHAREHOLDERS  
June 2, 2010**

**INTRODUCTION**

This Proxy Statement is being furnished to shareholders of American Shared Hospital Services, a California corporation (the Company), in connection with the solicitation of proxies by the Company's Board of Directors for use at the 2010 Annual Meeting of Shareholders scheduled to be held in the East Trianon Suite of The Carlyle Hotel, 35 East 76th Street, New York, NY at 10:00 a.m. Eastern Daylight Time on Wednesday, June 2, 2010 and at any adjournment or adjournments thereof (the Meeting). It is anticipated that this Proxy Statement and the Proxy will first be sent to shareholders on or about April 30, 2010.

The matters to be considered and voted upon at the Meeting will be:

1. To elect five persons to the Board of Directors to serve until the next Annual Meeting of Shareholders and until their successors are elected and have qualified.
2. To approve the amendment and restatement of the Company's 2006 Stock Incentive Plan.
3. To ratify the appointment of Moss Adams LLP as the Company's Independent Registered Public Accounting Firm for the year ending December 31, 2010.
4. To transact such other business as may properly be brought before the Meeting and any and all adjournments thereof.

Only shareholders of record at the close of business on April 23, 2010 (the Record Date) are entitled to notice of and to vote at the Meeting.

**Revocability of Proxies**

A proxy for use at the Meeting is enclosed. Any shareholder who executes and delivers such proxy may revoke it at any time prior to its use by filing with the Secretary of the Company either written instructions revoking such proxy or a duly executed proxy bearing a later date. Written notice of the death of the person executing a proxy, before the vote is counted, is tantamount to revocation of such proxy. A proxy may also be revoked by attending the Meeting and voting in person.

### **Solicitation of Proxies**

This proxy solicitation is being made by the Board of Directors of the Company. The expense of the solicitation will be paid by the Company. To the extent necessary to assure sufficient representation at the Meeting, proxies may be solicited by any appropriate means by directors, officers, regular employees of the Company and the stock transfer agent for the Common Shares, who will not receive any additional compensation therefor. The Company will request that banks, brokers and other fiduciaries solicit their customers who own beneficially the Common Shares listed of record in names of nominees and, although there is no formal arrangement to do so, the Company will reimburse such persons the reasonable expenses of such solicitation. In addition, the Company may pay for and utilize the services of individuals or companies not regularly employed by the Company in connection with the solicitation of proxies, if the Board of Directors of the Company determines that this is advisable.

### **Outstanding Securities**

The Board of Directors has fixed April 23, 2010 as the Record Date for the determination of shareholders entitled to notice of, and to vote at, the Meeting. At the close of business on the Record Date, there were estimated to

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be outstanding and entitled to vote 4,595,070 Common Shares. The Common Shares are the only class of securities entitled to vote at the Meeting.

### **Vote Required and Voting Procedures**

Each holder of Common Shares will be entitled to one vote, in person or by proxy, for each share standing in its name on the books of the Company as of the Record Date for the Meeting on each of the matters duly presented for vote at the Meeting, except as indicated below in connection with the election of directors.

In connection with the election of directors, shares are permitted to be voted cumulatively, if (i) a shareholder present at the Meeting has given notice at the Meeting, prior to the voting, of such shareholder's intention to vote its shares cumulatively and (ii) the names of the candidates for whom such shareholder desires to cumulate votes have been placed in nomination prior to the voting. If a shareholder has given such notice, all shareholders may cumulate their votes for candidates in nomination. Cumulative voting allows a shareholder to give one nominee as many votes as is equal to the number of directors to be elected, multiplied by the number of shares owned by such shareholder or to distribute votes on the same principle between two or more nominees. Discretionary authority to cumulate votes is hereby solicited by the Board of Directors.

In connection with the solicitation by the Board of Directors of proxies for use at the Meeting, the Board of Directors has designated Ernest A. Bates, M.D. and Craig K. Tagawa as proxies. Common Shares represented by properly executed proxies will be voted at the Meeting in accordance with the instructions specified thereon. If no instructions are specified, the Common Shares represented by any properly executed proxy will be voted FOR the (1) election of the five nominees for the Board of Directors named herein, (2) approval and adoption for the amended and restated 2006 Stock Incentive Plan and (3) ratification of the appointment of the Company's Independent Registered Public Accounting Firm.

The Board of Directors is not aware of any matters that will come before the Meeting other than as described above. However, if such matters are presented, the named proxies will, in the absence of instructions to the contrary, vote such proxies in accordance with the judgment of such named proxies with respect to any such other matter properly coming before the Meeting.

All outstanding shares of the Company's Common Stock represented by properly executed and unrevoked proxies received in time for the Meeting will be voted. A shareholder may, with respect to the election of directors, (i) vote for the election of all five nominees named herein as directors, (ii) withhold authority to vote for all such director nominees or (iii) vote for the election of all such director nominees other than any nominee(s) with respect to whom the shareholder withholds authority to vote by so indicating in the appropriate space on the proxy. Withholding authority to vote for a director nominee will not prevent such director nominee from being elected. A shareholder may, with respect to the proposal to approve the amendment and restatement of the Company's 2006 Stock Incentive Plan, (i) vote for the proposal, (ii) vote against the proposal, or (iii) abstain. A shareholder may, with respect to the proposal to ratify the appointment of the Company's Independent Registered Public Accounting Firm, (i) vote for the ratification, (ii) vote against the ratification, or (iii) abstain.

A proxy submitted by a shareholder may indicate that all or a portion of the shares represented by such proxy are not being voted by such shareholder with respect to a particular matter. This could occur, for example, when a broker is not permitted to vote stock held in street name on certain matters in the absence of instructions from the beneficial owner of the stock. The shares subject to any such proxy which are not being voted with respect to a particular matter (the non-voted shares) will be considered shares not present and entitled to vote on such matter, although such shares may be considered present and entitled to vote for other purposes and will count for purposes of determining the presence of a quorum. Abstentions are included in the determination of the number of shares represented at the

Meeting for purposes of determining whether a quorum is present and are counted as a vote against when determining whether a proposal has been approved.

The rules of the New York Stock Exchange determine whether proposals presented at shareholder meetings are routine or non-routine. If a proposal is routine, a broker or other entity holding shares for an owner in street name may vote for the proposal without receiving voting instructions from the owner under certain circumstances. If a proposal is non-routine, the broker or other entity may vote on the proposal only if the owner has provided voting

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instructions. A broker non-vote occurs when the broker or other entity is unable to vote on a proposal because the proposal is non-routine and the owner does not provide any voting instructions.

Beginning with the 2010 proxy season, the New York Stock Exchange has changed its rules to make the election of directors in an uncontested election a non-routine item. This means that brokers who do not receive voting instructions from their clients as to how to vote their shares for the election of directors cannot exercise discretion to vote for directors. Due to this rule change, at this year's annual meeting, the election of directors will be a non-routine item. Therefore, it is important that you instruct your broker as to how you wish to have your shares voted on these proposals, even if you wish to vote as recommended by the Board of Directors.

A majority of the Common Shares outstanding on the Record Date must be represented in person or by proxy at the Annual Meeting in order to constitute a quorum for the transaction of business. In the election of directors, the five candidates receiving the highest number of votes will be elected directors of the Company. The proposals to approve the amendment and restatement of the Company's 2006 Stock Incentive Plan and to ratify the appointment of the Company's Independent Registered Public Accounting Firm require that a majority of those voting in person or by proxy vote FOR this proposal, provided that affirmative vote also represents at least a majority of the voting power required to constitute a quorum at the Annual Meeting, in order for this proposal to be approved.

The Board of Directors has appointed Geraldine Zarbo of American Stock Transfer & Trust Company, the registrar and transfer agent for the Common Shares, or her designee, as the Inspector of Elections for the Annual Meeting. The Inspector of Elections will determine the number of Common Shares represented in person or by proxy at the Annual Meeting, whether a quorum exists, the authenticity, validity and effect of proxies and will receive and count the votes. The election of directors will not be by ballot unless a shareholder demands election by ballot at the Annual Meeting before the voting begins.

### **PROPOSAL NO. 1**

#### **ELECTION OF DIRECTORS**

##### **Board of Directors**

The Company's Bylaws provide that there shall be no fewer than five nor more than nine directors and that the exact number shall be fixed from time to time by a Resolution of the Board of Directors. The number of directors currently is fixed at five. There are currently no vacancies on the Board of Directors.

For many years our founder, Ernest A. Bates, M.D., has served as both Chairman and Chief Executive Officer of the Company. The Board believes that Dr. Bates' intimate knowledge of the Company's business and customers, and his significant ownership of our common stock, closely align him with the interests of all of our constituencies and position him well to lead the Board, which in turn determines the Company's overall direction. Since each of the Company's committees, through which the Board oversees management and reviews risk, is comprised only of independent directors, the Board has not considered it necessary to appoint a Lead Director. In addition, the small size of the Board makes communications among Directors and with management swift and simple and the independent directors see no benefit to adding one more layer of board governance.

The Board of Directors is proposing the persons named below for election to the Board of Directors. Each of the persons identified below will be nominated for election to serve until the next Annual Meeting of Shareholders and until their successors shall be elected and qualified. Votes will be cast pursuant to the enclosed proxy in such a way as to effect the election of each of the persons named below or as many of them as possible under applicable voting rules. If a nominee shall be unable or unwilling to accept nomination for election as a director, it is intended that the

proxy holders will vote for the election of such substitute nominee, if any, as shall be designated by the Board of Directors. Each of the nominees named below has notified the Board of Directors that, if elected, he is willing to serve as a director.

Set forth below is certain information regarding each of the nominees.

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**THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE ELECTION OF THE NOMINEES NAMED BELOW. PROPERLY EXECUTED PROXIES RETURNED TO THE COMPANY WILL BE VOTED FOR THE NOMINEES NAMED BELOW UNLESS OTHERWISE INSTRUCTED.**

**Nominees**

ERNEST A. BATES, M.D., founder of the Company, has served as Chairman of the Board and Chief Executive Officer since the Company's incorporation. A board-certified neurosurgeon, he is currently Emeritus Vice Chairman of the Board of Trustees of The Johns Hopkins University and serves on the Board of Visitors of the John Hopkins Medical Center and the John Hopkins Neurosurgery Advisory Board. He serves on the boards of the University of Rochester, FasterCures, Shared Imaging, LLC and the Salzburg Global Seminar. Dr. Bates was appointed to the California Commission for Jobs and Economic Growth and the Magistrate Judge Merit Selection Panel. From 1981-1987 he was a member of the Board of Governors of the California Community Colleges, and he served on the California High Speed Rail Authority from 1997 to 2003. Dr. Bates is a member of the Board of Overseers at the University of California, San Francisco, School of Nursing. He is a trustee of the Museum of the African Diaspora and a member of the Brookings and Milken Institutes. He is a graduate of the School of Arts and Sciences of Johns Hopkins University and the University of Rochester School of Medicine and Dentistry. Dr. Bates is 73 years old. Dr. Bates is the father of former Board Member and current Company Vice President of Sales and Business Development, Ernest R. Bates.

OLIN C. ROBISON has been a director since 2003. He was President and Chief Executive Officer of the Salzburg Seminar from 1991 to 2005 and President of Middlebury College from 1975 to 1990 and is currently President Emeritus and Professor Emeritus of that institution. Additionally, Mr. Robison is a Director of The Investment Company of America, American Mutual Fund and AMCAP (all of the American Funds Group) and is a former member of the Council (Board) of the Royal Institute of International Affairs in London. He received his undergraduate degree from Baylor University and holds a Doctor of Philosophy degree from Oxford University. Mr. Robison is 73 years old.

JOHN F. RUFFLE has been a director since 1995. He retired in 1993 as Vice-Chairman of the Board and a Director of J.P. Morgan & Co. Incorporated and Morgan Guaranty Trust Co. of New York. He is a Trustee Emeritus of The Johns Hopkins University. From December 1996 to May 2009 he was a member of the board of trustees of certain mutual funds in the J.P. Morgan Family of mutual funds and certain investment funds managed by J.P. Morgan Investment Management, Inc. From March 2004 to January 2007, he was a director for Reckson Associates Realty Corp. Mr. Ruffle graduated from The Johns Hopkins University, has an MBA in finance from Rutgers University, and is a Certified Public Accountant. Mr. Ruffle is 73 years old.

RAYMOND C. STACHOWIAK joined the Board of Directors in 2009, becoming the fifth member of the Board and the fourth outside Director. He founded Shared Imaging in 1994 with the purchase of the assets of Shared Imaging Partners, L.P. He has served as President and Chairman since its inception. In December 1999, he acquired Advanced Healthcare Resources, Inc. of Iowa. Together these entities comprise Shared Imaging, LLC. Shared Imaging, LLC is a preferred independent provider of CT, MRI and PET/CT equipment and services. He received his undergraduate degree in Business from Indiana University in 1979 and received an MBA from Indiana University in 1985. Mr. Stachowiak has CPA (Certified Public Accountant), CPIM (Certification in Production and Inventory Management) and CIA (Certified Internal Auditor) certifications. Mr. Stachowiak is 52 years old.

STANLEY S. TROTMAN, Jr., has been a director of the Company since 1996. He retired in 2000 as a Managing Director with the Health Care Group of PaineWebber Incorporated, an investment banking firm. Mr. Trotman was with PaineWebber since 1995 following its consolidation with Kidder, Peabody, also an investment banking firm, and since 1990 had co-directed Kidder, Peabody's Health Care Group. Prior to this position, he headed the Health Care

Group at Drexel Burnham Lambert, Inc. where he had been employed for approximately 22 years. He is currently a director of Web MD Health Corp. and Ascend Health Care Corp., and was a director of Oncure Medical Corp. from 1999 to 2007. Mr. Trotman received his undergraduate degree from Yale University in 1965 and obtained an MBA from Columbia Business School in 1967. Mr. Trotman is 66 years old.

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### **Meetings of the Board of Directors**

The Board of Directors of the Company held four regular meetings and one special meeting during 2009. All directors attended at least 75% of the aggregate number of meetings of both the Board of Directors and of the Committees of the Board on which such director served during the year.

Shareholders may communicate with the Board by writing to: Four Embarcadero Center, Suite 3700; San Francisco, CA 94111-4107, Attention: Ernest A. Bates, M.D. We encourage directors to attend our annual meeting and all directors attended the 2009 Annual Meeting in person. All shareholder communications to directors are forwarded to them.

### **Committees of the Board of Directors**

The Company has standing Compensation, Nominating and Corporate Governance and Audit Committees, each of which is described below. The Company is in compliance with The NYSE Amex Stock Exchange ( AMEX ) enhanced board and board committee independence requirements that became fully applicable to the Company effective July 31, 2005. Thus, a majority of our directors (Messrs. Robison, Ruffle, Stachowiak and Trotman) are independent under the AMEX rules and Rule 10A-3 under the Securities Exchange Act and each of the Committees described above is comprised of independent directors. Each of the Audit, Compensation and Nominating and Corporate Governance Committees has adopted a formal written charter. These, as well as our Code of Professional Conduct and Ethics, are available on our website at [www.ashs.com](http://www.ashs.com). You may also request a copy of these documents free of charge by writing our Corporate Secretary. We intend to post on our website any amendments to our Code of Professional Conduct and Ethics, as well as any waivers for directors or executive officers (including our chief accounting officer and controller and anyone else performing similar functions) within five business days after the date of any amendment or waiver. The information on our website is not part of this proxy statement. The Company's independent directors meet at least annually without management and the non-independent directors, as required by the AMEX rules.

The Compensation Committee's functions are to (i) establish compensation arrangements and incentive goals for executive officers, (ii) administer compensation plans, (iii) evaluate the performance of executive officers and award incentive compensation, (iv) adjust compensation arrangements as appropriate based upon performance, and (v) review and monitor management development and succession plans and activities. The Compensation Committee met once during 2009. The Compensation Committee consists of Mr. Robison, Mr. Ruffle and Mr. Trotman. Mr. Robison is Chair of the Compensation Committee.

The Compensation Committee is authorized to delegate its authority to a subcommittee when appropriate. It is authorized to hire independent compensation consultants and other professionals to assist in the design, formulation, analysis and implementation of compensation programs for the Company's executive officers and other key employees. In determining or recommending the amount or form of executive officer compensation, the Compensation Committee also takes into consideration information received from the Company's Chief Executive Officer. In doing so, however, the Compensation Committee customarily considers the comparative relationship of the recommended compensation to the compensation paid by other similarly situated companies, individual performance, tenure, internal comparability and the achievement of certain other operational and qualitative goals identified in the Company's strategic plan.

The purpose of the Nominating and Corporate Governance Committee is to recommend candidates for election to the Board of Directors. The Company adopted a Nominating and Corporate Governance Committee Charter in 2006 which is available on our website. The Nominating and Corporate Governance Committee met once during 2009. In 2010, the Nominating and Corporate Governance Committee recommended to the Board the nominations of

Dr. Bates, Mr. Robison, Mr. Ruffle, Mr. Stachowiak and Mr. Trotman for election to the Board. Mr. Robison, Mr. Ruffle, Mr. Stachowiak and Mr. Trotman serve on the Nominating and Corporate Governance Committee. Mr. Trotman is Chair of the Nominating and Corporate Governance Committee.

The purpose of the Audit Committee is to review the financial reporting and internal controls of the Company, to appoint the independent auditors, and to review the reports of such auditors. The Audit Committee consists of Mr. Robison, Mr. Ruffle, Mr. Stachowiak and Mr. Trotman. Mr. Ruffle is Chair of the Audit Committee. During the



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year 2009 the Audit Committee held four regular meetings and three telephonic meetings. For further information concerning the Audit Committee, refer to the Audit Committee Report. Mr. Ruffle is a financial expert and meets the applicable independence requirements of AMEX and Rule 10-A-3 under the Securities Exchange Act.

### **Identifying and Evaluating Director Nominees**

The Nominating and Corporate Governance Committee uses various methods to identify director nominees. The Nominating and Corporate Governance Committee assesses the appropriate size and composition of the Board and the particular needs of the Board based on whether any vacancies are expected due to retirement or otherwise. Candidates may come to the attention of the Nominating and Corporate Governance Committee through current board members, shareholders, or other sources. All candidates are evaluated based on a review of the individual's qualifications, skills, independence and expertise.

To be eligible for consideration to the Board, any proposed candidate must be ethical, have proven judgment and experience, have professional skills and experience in dealing with complex problems that would be complementary to the needs of the Company, have demonstrated the ability to act independently, be willing to represent the interests of all shareholders and not just those of a particular interest, and be willing and able to devote sufficient time to fulfill the needs of a director of the Company.

The Nominating and Corporate Governance Committee will consider director candidates submitted by shareholders to: Four Embarcadero Center, Suite 3700, San Francisco, CA 94111-4107, Attention: Nominating and Corporate Governance Committee. Such recommendations should be accompanied by (i) evidence of the shareholder's stock ownership over the last year, (ii) a statement that the shareholder is not a competitor of the Company, (iii) a resume and contact information for the director candidate, as well as a description of the candidate's qualifications and (iv) a statement whether the candidate has expressed interest in serving as a director. The Nominating and Corporate Governance Committee follows the same process and uses the same criteria for evaluating candidates proposed by shareholders as it does for candidates proposed by other parties. The Nominating and Corporate Governance Committee will consider such candidacy and will advise the recommending shareholder of its final decision. A shareholder who wishes to nominate a person for director must provide the nomination in writing to the Secretary at the Company's principal offices pursuant to the notice provisions in the By-laws. Such notice must be received not less than 60 nor more than 90 days prior to the Annual Meeting or, if less than 70 days' notice of the date of such meeting has been given, then within 10 business days following the first public disclosure of the meeting date or the mailing of the Company's notice. Any such notice must contain information regarding the nominee and the proponent. Details concerning the nature of such information are available without charge from the Company.

Based on the process described above, the Committee recommended and the Board determined to nominate each of the incumbent directors for re-election at the 2010 Annual Meeting of Shareholders. The Committee and Board concluded that each of the incumbent Directors should be nominated for re-election based on the experience, qualifications, attributes and skills identified in the biographical information contained under Election of Directors on pages 6 - 8. The Committee and the Board assessed these factors while considering the Company's long-standing history of providing Gamma Knife and other medical services to hospitals and medical centers in the United States, and its anticipated growth in providing similar services internationally, as well as providing proton beam radiation therapy services in the United States. In particular, the Committee and the Board considered the following factors:

Each nominee has extensive experience in guiding other organizations as both executive leaders and board members;

The nominees' experiences reflect a range of occupations and industries which helps to provide differing viewpoints to help guide the Company. This specifically includes financial services (Mr. Ruffle and

Mr. Trotman), health care (Dr. Bates, Mr. Stachowiak and Mr. Trotman), government and public policy (Mr. Robison and Mr. Ruffle), international policy and development (Mr. Robison, Mr. Ruffle and Mr. Trotman), business development (Dr. Bates and Mr. Stachowiak);

The nominees have significant and substantive expertise in several areas that are applicable to the Board and its committees, including finance (all of the nominees), public company accounting and financial reporting

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(Mr. Ruffle and Mr. Stachowiak), strategic planning (all of the nominees), operations management (all of the nominees) and corporate governance (all of the nominees);

The Board particularly believes that Dr. Bates' vast experience in the medical community both as a neurosurgeon and as an entrepreneur, as founder, President and CEO of the Company, brings unparalleled expertise to the board in a variety of areas.

**Director Compensation**

The following table sets forth information regarding the compensation earned by or awarded to each non-employee director during the 2009 Fiscal Year.

Name (a)	Fees Earned or		Option Awards (\$)(4)(5) (d)	All Other Compensation (\$) (e)	Total (\$) (f)
	Paid in Cash (\$)(1) (b)	Stock Awards (\$)(2)(3) (c)			
Olin C. Robison	20,000	1,050	3,606	0	24,656
John F. Ruffle	20,000	1,050	3,606	0	24,656
Raymond C. Stachowiak	10,000	1,410	12,499	0	23,909
Stanley S. Trotman	20,000	1,050	3,606	0	24,656

- (1) Consists of the annual retainer fees for service as members of the Company's board of directors.
- (2) The amounts in column (c) reflect the grant date fair value dollar amount of stock awards granted to each non-employee director, computed in accordance with FASB ASC Topic 718. Assumptions used in the calculation of this amount are included in Note 9 to the Company's audited financial statements for the fiscal year ended December 31, 2009 and included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2010. For further information concerning the restricted stock unit awards granted under the 2006 Stock Incentive Plan, see the section below entitled *Directors' Equity Grants*.
- (3) As of December 31, 2009, the following non-employee directors each held stock awards granted during 2009 covering 500 shares of the Company's Common Stock: Mr. Robison, Mr. Ruffle, Mr. Stachowiak and Mr. Trotman.
- (4) The amounts in column (d) reflect the grant date fair value dollar amount of stock option awards granted to each non-employee director, computed in accordance with FASB ASC Topic 718. Assumptions used in the calculation of this amount are included in footnote 9 to the Company's audited financial statements for the fiscal year ended December 31, 2009 and included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2010. The 2,000-share annual stock option award granted during the 2009 fiscal year was at an exercise price per share of \$2.10. Mr. Stachowiak's initial 5,000 option award upon joining the board was at an exercise price of \$2.82. For further information concerning the stock option awards granted under the 2006 Stock Incentive Plan, see the section below entitled *Directors' Equity Grants*.
- (5) As of December 31, 2009 the following non-employee directors held options to purchase the following number of shares of the Company's common stock: Mr. Robison, 29,000 shares; Mr. Ruffle, 17,000 shares;

Mr. Stachowiak, 5,000 shares; and Mr. Trotman, 17,000 shares. The options were granted under the Company's 2006 Stock Incentive Plan. For further information concerning the grant of options to non-employee directors under such plan, see the section below entitled *2006 Stock Incentive Plan*.

*Directors Annual Retainer Fees*

In 2009, non-employee directors were paid an annual retainer of \$20,000, payable quarterly. New board member Mr. Stachowiak was paid a \$10,000 pro-rata share of the retainer. Non-employee directors also received reimbursement of expenses incurred in attending meetings. No payment is made for attendance at meetings by any director who is a full time employee of the Company.

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*Directors Equity Grants*

Under the 2006 Stock Incentive Plan (the "2006 Stock Plan"), each individual who first becomes a non-employee director will, at the time of his or her election to the board, receive an option grant to purchase a specified number of shares of our common stock and a restricted stock unit award covering an additional number of shares of our common stock, provided that such individual has not previously been in the employ of the Company or any of its parents or subsidiaries. The specific number of shares subject to the initial award will be determined by the Compensation Committee of our Board of Directors, but will not exceed 10,000 shares for the option component or 3,000 shares for the restricted stock unit component. In addition, on the date of each Annual Shareholders Meeting, each individual who will continue to serve as a non-employee director will automatically be granted an option to purchase a specified number of shares of our common stock and a restricted stock unit award covering an additional number of shares of our common stock, provided such individual has served as a non-employee director for at least six months. The specific number of shares subject to the annual award will be determined by the Compensation Committee of our Board of Directors, but will not exceed 3,000 shares for the option component or 750 shares for the restricted stock unit component. There will be no limit on the number of such annual awards any one eligible non-employee director may receive over his or her period of continued service on the Board of Directors, and non-employee directors who have previously been in the Company's employ will be eligible to receive one or more such annual awards over their period of service on the Board of Directors. Each initial stock option and restricted stock unit award will vest in four equal annual installments upon the individual's completion of each year of service. Each annual stock option and restricted stock award will vest in one installment upon the individual's completion of one year of board service.

On the day of the 2009 Annual Meeting, non-employee Board members Mr. Robison, Mr. Ruffle and Mr. Trotman each received an option to purchase 2,000 shares of the Company's common stock at an exercise price of \$2.10 per share, the fair market value of the Company's common stock on that date, and a grant of 500 restricted stock units pursuant to the terms of the 2006 Plan. Upon joining the Board of Directors on September 10, 2009, Mr. Stachowiak received an initial award consisting of an option to purchase 5,000 shares of the Company's stock at an exercise price of \$2.82, the fair market value of the Company's stock on that date, and a grant of 500 restricted stock units.

On the day of the 2010 Annual Meeting, upon re-election to the Board, non-employee Board members Mr. Robison, Mr. Ruffle, Mr. Stachowiak and Mr. Trotman will each receive an option to purchase 2,000 shares of the Company's common stock at an exercise price per share equal to the fair market value of the Company's common stock on the date of the Annual Meeting, and a grant of 500 restricted stock units pursuant to the terms of the 2006 Plan.

**Table of Contents****CERTAIN ADDITIONAL INFORMATION****Security Ownership of Certain Beneficial Owners and Management**

The following table sets forth certain information regarding the beneficial ownership of the Company's Common Shares as of April 1, 2010, of (i) each person known to the Company to own beneficially 5% or more of the Common Shares, (ii) each nominee for director of the Company, (iii) each executive officer named in the Summary Compensation Table, and (iv) all directors and executive officers as a group. Except as otherwise indicated in the footnotes to the table or for shares of common stock held in brokerage accounts, which may from time to time, together with other securities held in those accounts, serve as collateral for margin loans made from such accounts, none of the shares reported as beneficially owned are currently pledged as security for any outstanding loan or indebtedness.

<b>Name and Address of Beneficial Owner</b>	<b>Common Shares Owned Beneficially Amount and Nature of Beneficial Ownership(2)</b>	<b>Percent of Class(3)</b>
Directors and Named Officers		
Ernest A. Bates, M.D.(1) Chairman of the Board and Chief Executive Officer	893,537	19.1%
Olin C. Robison(1)(4)	28,350	*
John F. Ruffle(1)(4)	216,761	4.7%
Raymond C. Stachowiak(1)(4)	26,167	*
Stanley S. Trotman, Jr.(1)(4)	183,137	4.0%
Ernest R. Bates(1)(4) Vice President of Sales and Business Development	75,345	1.6%
Craig K. Tagawa(1)(4) Senior Vice President, Chief Operating and Financial Officer	104,823	2.3%
All Current Directors & Executive Officers as a Group (7 people)(4)	1,528,120	31.4%
5% or More Shareholders		
None		

\* Less than 1%

- (1) The address of each such individual is c/o American Shared Hospital Services, Four Embarcadero Center, Suite 3700, San Francisco, California 94111.
- (2) Each person directly or indirectly has sole voting and investment power with respect to the shares listed under this column as being owned by such person.
- (3) Shares that any person or group of persons is entitled to acquire upon the exercise of options or warrants within 60 days after April 1, 2010, are treated as issued and outstanding for the purpose of computing the percent of the class owned by such person or group of persons but not for the purpose of computing the percent of the class owned by any other person.

- (4) Includes shares underlying options that are currently exercisable or will become exercisable within 60 days following April 1, 2010: Dr. Bates, 94,167 shares; Mr. Bates, 58,516 shares; Mr. Robison, 26,850 shares; Mr. Ruffle, 14,850 shares; Mr. Stachowiak, 1,167 shares; Mr. Trotman, 14,850 shares; Mr. Tagawa, 62,591 shares; and Directors and Executive Officers as a group, 272,991 shares.

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**COMPENSATION OF EXECUTIVE OFFICERS**

**Compensation Discussion and Analysis**

*Introduction.* It is our intent in this Compensation Discussion and Analysis to inform our shareholders of the policies and objectives underlying the compensation programs for our three executive officers, Dr. Ernest A. Bates, Chairman of our Board and our Chief Executive Officer, Craig K. Tagawa, our Chief Financial Officer and Chief Operating Officer, and Ernest R. Bates, our Vice President of Sales and Business Development. The Compensation Committee of our Board of Directors administers the compensation programs for our executive officers with the objective of providing a competitive compensation package. However, we believe that the compensation paid to our executive officers should also be substantially dependent on our financial performance and the value created for our shareholders. For this reason, the Compensation Committee also utilizes our compensation programs to provide meaningful incentives for the attainment of our short-term and long-term strategic objectives and thereby reward those executive officers who make a substantial contribution to the attainment of those objectives.

*Compensation Policy for Executive Officers.* We have designed the various elements comprising the compensation packages of our executive officers to achieve the following objectives:

attract, retain, motivate and engage executives with superior leadership and management capabilities,

provide an overall level of compensation to each executive officer which is externally competitive, internally equitable and performance-driven, and

ensure that total compensation levels are reflective of our financial performance and provide the executive officer with the opportunity to earn above-market total compensation for exceptional business performance.

Each executive officer's compensation package typically consists of three elements: (i) a base salary, (ii) a cash bonus tied to our attainment of financial objectives or the individual officer's personal performance, and (iii) long-term, stock-based incentive awards designed to align and strengthen the mutuality of interests between our executive officers and our shareholders. In determining the appropriate level for each element of such compensation, the Compensation Committee subjectively reviews and evaluates the level of performance of the Company and the executive's level of individual performance and potential to contribute to the Company's future growth, and seeks to set compensation at a level that is both reasonable and equitable based on that assessment. Consistent with our philosophy of emphasizing pay for performance, the total compensation packages are designed to pay above the target when the Company exceeds its goals and below the target when the Company does not achieve its goals.

*Elements of Compensation.* Each of the three major elements comprising the compensation package for our executive officers (salary, bonus and equity) is designed to achieve one or more of our overall objectives in fashioning a competitive level of compensation, tying compensation to the attainment of one or more of our strategic business objectives and subjecting a substantial portion of the executive officer's compensation to our financial success as measured in terms of our stock price performance. The manner in which the Compensation Committee has so structured each element of compensation may be explained as follows.

*Base Salary.* The Compensation Committee reviews the base salary level of each executive officer each year. The base salary for the executive officers is determined on the basis of their level of responsibility, experience and individual performance. No changes were made in fiscal 2009.



*Cash Incentive Compensation.* Because the Compensation Committee believes that the significant interests which Dr. Bates, Mr. Tagawa and Mr. Bates have in our common stock provide them with a substantial incentive to contribute to our financial success and the attainment of our financial goals, the Compensation Committee does not typically implement annual incentive compensation programs for them. From time to time, the Compensation Committee awards cash bonuses in recognition of their personal performance. However, for the 2009 fiscal year, no cash bonuses were awarded by the Compensation Committee to the Company's executive officers.

In 2006 the Board approved the Company's Long Term Incentive Compensation Plan (the Incentive Plan), which was subsequently approved by the Company's shareholders at the 2006 Annual Meeting. The Compensation Committee has the discretion under the Incentive Plan to implement one or more performance periods, each consisting of one or more calendar years up to a maximum of five years. The Compensation Committee will

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establish the specific performance goals for each performance period and the specific formula for calculating the bonus to which the executive may become entitled within the first ninety days of that performance period, and will establish threshold, target and maximum levels of attainment. The maximum bonus payable per participant will be determined by multiplying the number of calendar years in the performance period by \$250,000. To date, we have not used the Incentive Plan.

*Equity Compensation.* In 2006 the Board approved the 2006 Stock Incentive Plan (the 2006 Plan ) to replace the Company's 2001 Stock Option Plan, and the 2006 Plan was approved by our stockholders at the 2006 Annual Meeting. For many years stock option grants were the sole form of equity award granted to our executive officers, and we continue to use stock option grants to provide long-term incentives to our executive officers. However, we structured the 2006 Plan to provide us with more flexibility in designing equity incentives in an environment where a number of companies have moved from traditional option grants to other stock or stock-based awards, such as stock appreciation rights, restricted stock and restricted stock units. Accordingly, with the 2006 Plan, we have a broad array of equity incentives to utilize for purposes of attracting and retaining the services of key individuals, including stock options, stock appreciation rights, restricted stock, restricted stock units, and other stock-based awards. We continue to rely on equity incentives because we believe that such incentives are necessary for us to remain competitive in the marketplace for executive talent and other key employees.

The Compensation Committee reviews and considers equity awards in connection with the annual review of the performance of our executive officers and other key employees. However, there may be variance from this practice when warranted by special circumstances. Each grant is designed to align the interests of the executive officer with those of the shareholders and to provide each individual with a significant incentive to manage the company from the perspective of an owner with an equity stake in the business. In past years, the equity awards have been in the form of stock options which generally vest and become exercisable in a series of installments over a five year service period, contingent upon the officer's continued employment with us. Accordingly, each such option will provide a return to the executive officer only to the extent he remains employed with us during the vesting period, and then only if the fair market value of the underlying shares appreciates over the period between grant and exercise of the option. No options were awarded to the Company's executive officers in 2009.

*Market Timing of Equity Awards.* The Compensation Committee does not engage in any market timing of the equity awards made to the executive officers or other award recipients. As indicated above, awards for existing executive officers and employees are considered in connection with the annual review process which typically occurs in the fourth quarter each year. There is no established practice of timing our awards in advance of the release of favorable financial results or adjusting the award date in connection with the release of unfavorable financial developments affecting our business. Equity awards for new hires other than executive officers are typically made at the next scheduled Compensation Committee meeting following the employee's hire date. All stock option grants issued under our 2006 Plan have an exercise price per share no less than the fair market value per share on the grant date.

*Executive Officer Perquisites.* It is not our practice to provide our executive officers with any meaningful perquisites.

*Other Programs.* Our executive officers are eligible to participate in our 401(k) plan and our flexible benefit plan on the same basis as all other regular U.S. employees.

*Deferred Compensation Programs.* We have not implemented any non-qualified deferred compensation programs for our executive officers or any supplemental executive retirement plans.

*Compliance with Internal Revenue Code Section 162(m).* Section 162(m) of the Internal Revenue Code disallows a tax deduction to publicly held companies for compensation paid to certain of their executive officers to the extent such compensation exceeds \$1.0 million per covered officer in any year. The limitation applies only to compensation that is

not considered to be performance-based under the terms of Section 162(m). The stock options which have been granted to date to our executive officers have been structured so as to qualify as performance based compensation. Non-performance-based compensation paid to such officers for 2009 did not exceed the \$1.0 million limit per officer. However, we believe that in establishing the cash and equity incentive compensation programs for our executive officers, the potential deductibility of the compensation payable under those programs should be only

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one of a number of relevant factors taken into consideration, and not the sole governing factor. For that reason, we may deem it appropriate to provide one or more executive officers with the opportunity to earn incentive compensation, whether through cash bonuses under the 2006 Incentive Plan or through equity awards, which together with base salary in the aggregate may be in excess of the amount deductible by reason of Section 162(m) or other provisions of the Internal Revenue Code. We believe it is important to maintain cash and equity incentive compensation at the levels needed to attract and retain the executive officers essential to our success, even if all or part of that compensation may not be deductible by reason of the Section 162(m) limitation.

**Summary Compensation Information**

The following table provides certain summary information concerning the compensation earned for services rendered in all capacities to the Company and its subsidiaries for the year ended December 31, 2009 by the Company's Chief Executive Officer, Chief Financial Officer and Vice President of Business Development. No other executive officers who would have otherwise been includable in such table on the basis of total compensation for the 2009 Fiscal Year are required to be included by reason of their termination of employment or change in executive status during that year. The listed individuals are hereinafter referred to as the named executive officers.

<b>Name and Principal Position (a)</b>	<b>Year (b)</b>	<b>Salary (\$ (1) (c)</b>	<b>Bonus (\$ (2) (d)</b>	<b>Option Awards (\$ (3) (e)</b>	<b>All Other Compensation (\$ (4) (f)</b>	<b>Total (\$ (g)</b>
Ernest A. Bates,	2009	475,000	0	0	33,108	508,108
M.D. Chairman of the Board and Chief Executive Officer	2008	475,000	47,500	40,500	29,316	592,316
Craig K. Tagawa,	2009	300,000	0	0	10,695	310,695
Chief Operating Officer and Chief Financial Officer	2008	300,000	30,000	0	16,268	346,268
Ernest R. Bates,	2009	250,000	0	0	15,607	265,607
Vice President of Business Development	2008	250,000	25,000	0	15,000	290,000

- (1) Includes amounts deferred under the Company's Retirement Plan for Employees of American Shared Hospital Services, a qualified plan under section 401(k) of the Internal Revenue Code.
- (2) Bonuses were accrued in 2008 and paid in first quarter 2009.
- (3) The amounts in column (e) reflect the aggregate grant date fair value of stock options granted to each named executive officer, computed in accordance with FASB ASC Topic 718. Assumptions used in the calculation of this amount are included in Note 9 to the Company's audited financial statements for the fiscal year ended December 31, 2009 and included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2010.
- (4) The amounts in column (f) include matching contributions under the Company's 401K plan, automobile and parking allowance, income attributable to life insurance coverage paid by us, personal use of the Company's leased apartment, and premiums paid by the Company for long term disability coverage.



**Table of Contents****Outstanding Equity Awards at Fiscal Year-End**

The following table provides information concerning outstanding equity awards held by the named executive officers as of December 31, 2009.

Name	Number of Securities Underlying Unexercised Options Exercisable (#)	Option Awards		
		Number of Securities Underlying Unexercised Options Unexercisable (#)	Option Exercise Price (\$)	Option Expiration Date
Ernest A. Bates, M.D.	60,000	90,000	\$ 3.036	December 5, 2014
	17,500	32,500	\$ 2.959	March 7, 2015
Craig K. Tagawa	13,050	1,450	\$ 6.16	June 15, 2015
	40,000	60,000	\$ 2.76	December 5, 2014
Ernest R. Bates	28,333	21,667	\$ 6.50	February 7, 2014
	10,000	15,000	\$ 2.76	December 5, 2014

(1) The option shares vest in five equal annual installments over the five year period measured from their issue date (which was seven years before the expiration date, or ten years in the case of Mr. Tagawa's award expiring in 2015), provided each employee continues to provide services to the Company through each applicable vesting date. None of the option shares authorized under these awards had been exercised as of December 31, 2009.

**Grants of Plan-Based Awards**

There were no stock options or stock awards granted in 2009 to any of the Company's executive officers named in the Summary Compensation Table.

**Payments upon Termination or Change in Control**

Under our 2006 Stock Plan, in the event a change in control occurs, each outstanding equity award under the Discretionary Grant Program will automatically accelerate in full, unless (i) that award is assumed by the successor corporation or otherwise continued in effect or (ii) the award is replaced with a cash retention program that preserves the spread existing on the unvested shares subject to that equity award (the excess of the fair market value of those shares over the exercise or base price in effect for the shares) and provides for subsequent payout of that spread in accordance with the same vesting schedule in effect for those shares. In addition, all unvested shares outstanding under the Discretionary Grant and Stock Issuance Programs will immediately vest upon the change in control, except to the extent our repurchase rights with respect to those shares are to be assigned to the successor corporation or otherwise continued in effect. Each outstanding equity award under the Stock Issuance Program, including restricted stock units, will vest as to the number of shares of common stock subject to that award immediately prior to the change in control and the underlying shares will become immediately issuable, unless that equity award is assumed by the successor corporation or otherwise continued in effect or replaced with a cash retention program similar to the program described in clause (ii) above.

The plan administrator has the discretion to structure one or more equity awards under the 2006 Plan so that those equity awards will vest in full either immediately upon a change in control or in the event the individual's service with us or the successor entity is terminated (actually or constructively) within a designated period following a change in control transaction, whether or not those equity awards are to be assumed or otherwise continued in effect or replaced with a cash retention program.

Options granted under our 1995 and 2001 Stock Option Plans provide that in the event of (i) a change in control of the company in which the holders of the Company's common stock receive consideration other than shares of common stock registered under Section 12 of the Securities Exchange Act of 1934, (ii) any person acquiring beneficial ownership of 25% or more of either the corporation's outstanding common stock or the company's outstanding voting securities, or (iii) a hostile take-over of the Company's board, options will be cancelled in

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exchange for a cash payment from the Company in an amount equal to the number of shares of common stock at that time subject to such option, multiplied by the excess, if any, of the greater of (A) the highest per share price offered to the stockholders of the Company in any transaction whereby the change in control takes place or (B) the fair market value of a share of common stock on the date of occurrence of the change in control over the exercise price per share of common stock in effect under that option.

Upon a qualifying change in control of the Company, executive officers would potentially receive compensation pursuant to unvested option grants originally awarded under the 1995 plan. Only Mr. Tagawa has options awarded under the 1995 plan. Assuming a change in control occurred on December 31, 2009 and the change in control consideration paid per share was equal to the closing selling price of our common stock on December 31, 2009, which was \$2.88 per share, the option strike price for his award under the 1995 plan is greater than the closing selling price on that date, and so no compensation would have been paid to him.

**Shares Authorized for Issuance Under Equity Compensation Plans**

The following table provides information as of December 31, 2009 with respect to shares of our common stock that may be issued under our existing equity compensation plan.

<b>Plan Category</b>	<b>Number of Shares to be Issued upon Exercise of Outstanding Options, Warrants and Rights</b>	<b>Weighted Average Exercise Price of Outstanding Options, Warrants and Rights</b>	<b>Number of Shares Remaining Available for Future Issuance</b>
Equity compensation plans approved by security holders (1)	600,930(2)	\$ 3.72(3)	142,070(4)
Equity compensation plans not approved by security holders	N/A	N/A	N/A
<b>Total</b>	<b>600,930</b>	<b>\$ 3.72</b>	<b>142,070</b>

(1) Consists of our 2006 Plan.

(2) Includes 2,000 shares of our common stock subject to restricted stock unit awards that will entitle each holder to one share of our common stock for each such unit that vests over the holder's period of continued service.

(3) Calculated without taking into account 2,000 shares of common stock subject to outstanding restricted stock unit awards that will become issuable, as those units vest, without any cash consideration or other payment required for such shares.

(4) Shares reserved for issuance under the 2006 Plan may be issued upon the exercise of stock options or stock appreciation rights, through direct stock issuances or pursuant to restricted stock units or other stock based awards that vest upon the attainment of prescribed performance milestones or the completion of designated service periods.

**Compliance with Section 16(a) under the Securities Exchange Act of 1934**



Reports filed under the Exchange Act and received by the Company on or after January 1, 2009, indicate that during 2009 directors, officers and 10% shareholders of the Company filed all required reports within the periods established by applicable rules, with the following exceptions: (1) On May 28, 2009 John F. Ruffle acquired 500 shares of the Company's stock, which was not reported to the Securities and Exchange Commission until August 25, 2009; (2) On May 28, 2009 Olin C. Robison acquired 500 shares of the Company's stock, which was not reported to the Securities and Exchange Commission until August 25, 2009; (3) On May 28, 2009 Stanley S. Trotman, Jr. acquired 500 shares of the Company's stock, which was not reported to the Securities and Exchange Commission until November 5, 2009; (4) On August 20, 2009 Ernest A. Bates, M.D. sold 50,000 shares of the Company's stock, which was not reported to the Securities and Exchange Commission until August 26, 2009; (5) On August 20, 2009 Craig K. Tagawa sold 10,000 shares of the Company's stock, which was not reported to the Securities and Exchange Commission until August 26, 2009.

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**CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

**Compensation Committee Interlocks and Insider Participation**

None.

**Policies and Procedures**

The Audit Committee of the Board of Directors is responsible for reviewing and approving all related party transactions as defined under Securities and Exchange Commission rules and regulations. While we do not have a formal written policy or procedure for the review, approval or ratification of related party transactions, the audit committee must review the material facts of any such transaction and approve that transaction.

To identify related party transactions, each year we submit and require our directors and officers to complete director and officer questionnaires identifying transactions with the Company in which the director or officer or their family members have a conflict of interest. The Company reviews the questionnaire for potential related party transactions. In addition, at any scheduled meeting of the audit committee, management may recommend related party transactions to the committee, including the material terms of the proposed transactions, for its consideration.

In making its decision to approve or ratify a related party transaction, the audit committee will consider all relevant facts and circumstances available to the committee, including factors such as the aggregate value of the transaction, whether the terms of the related party transaction are no less favorable than terms generally available in an arms length transaction and the benefit of such transaction to us.

**AUDIT COMMITTEE REPORT**

The following Report of the Audit Committee does not constitute soliciting material and should not be deemed filed or incorporated by reference into any other filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent the Company specifically incorporates the Report by reference therein.

The Audit Committee of the Board of Directors consists of four directors, all of whom are independent as defined in the listing standards of the AMEX. The primary purpose of the Audit Committee is to review the financial reporting and internal controls of the Company, to appoint independent auditors, to review the reports of such auditors, and to review annually the Audit Committee charter. During 2009, the Audit Committee held seven meetings, three of which were held telephonically. Mr. Ruffle is Chair of the Audit Committee.

The Audit Committee reviewed and held discussions with management and the independent auditors regarding the financial statements of the Company for the fiscal year ended December 31, 2009. These discussions included the quality of the Company's internal controls, the audit plans, audit scope and identification of audit risks. In addition, the Committee assured that the independent auditors reviewed and discussed with management the interim financial reports prior to each quarterly earnings announcement.

The Company's independent auditors provided a formal written statement that described all relationships between the auditors and the Company with respect to the auditors' independence within the meaning of the federal securities laws administered by the US Securities and Exchange Commission, and the Audit Committee satisfied itself as to the auditors' independence.

The Audit Committee discussed with the Independent Registered Public Accounting Firm all matters required to be discussed by Statement on Auditing Standards No. 61, as amended, *Communication with Audit Committees* and, with and without the presence of management, reviewed and discussed the results of the independent auditors' examination of the Company's financial statements. Management, being responsible for the Company's financial statements, represented that the Company's consolidated financial statements were prepared in accordance with generally accepted accounting principles. The independent auditors are responsible for the examination of those statements.

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Based on the Audit Committee's discussions with management and the independent auditors, and the Audit Committee's review as described previously, the Audit Committee recommended to the Board of Directors that the Company's audited financial statements be included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2009, as filed with the Securities and Exchange Commission.

Submitted by the Audit Committee of the Board of Directors:

John F. Ruffle (chairman)  
Olin C. Robison  
Raymond C. Stachowiak  
Stanley S. Trotman, Jr.

**PROPOSAL NO. 2**

**APPROVAL OF THE AMENDMENT AND RESTATEMENT OF THE 2006 STOCK INCENTIVE PLAN**

Our shareholders are being asked to approve an amendment and restatement of our 2006 Stock Incentive Plan (the Plan) that will effect the following principal changes:

(i) The number of shares of our common stock reserved for issuance under the Plan will be increased by an additional 880,000 shares, from 750,000 shares to 1,630,000 shares.

(ii) The number of shares of our common stock that may be issued pursuant to tax-favored incentive stock options under Section 422 of the Internal Revenue Code (the Code) will be increased by the same 880,000 share increase to the authorized reserve under the Plan.

(iii) The number of shares of our common stock reserved for award and issuance under the Plan will be reduced by a ratio of 1.59 shares of common stock for each share of common stock that is issued pursuant to a Full Value Award (as such term is defined below) made under the Plan after March 18, 2010. For all other share issuances under the Plan, the share reserve will continue to be reduced on a one-for-one basis.

(iv) A new Incentive Bonus Program will be added, pursuant to which eligible persons may be provided with incentive bonus opportunities through performance unit awards and special cash incentive programs tied to the attainment of pre-established performance milestones. Awards under such program may be structured to qualify as performance-based compensation for purposes of Section 162(m) of the Code, as described below.

(v) The limit on the number of shares of common stock for which awards may be made to any one participant in any calendar year will be changed from a single 150,000-share limitation to the following limits:

for awards denominated in terms of shares of our common stock, the maximum number of shares of common stock for which such awards may be made to any one person in any calendar year will not exceed 150,000 shares in the aggregate; provided, however, that for a calendar year in which a person first commences service, the foregoing limitation will be increased to 200,000 shares; and

for awards denominated in terms of cash and subject to one or more performance-vesting conditions, the maximum dollar amount for which such awards may be made to any one person in any calendar year will not exceed \$1,500,000.00 for each calendar year within the applicable performance measurement period, with any such performance period not to exceed five (5) years and with pro-ration based on the foregoing dollar amount in the event of any fractional calendar year included within such performance period.

(vi) Any accrued dividend equivalents on performance-based awards will be subject to the attainment of the applicable performance goals for those awards.

(vii) No out-of-the money stock options or stock appreciation rights may be cashed out without shareholder approval. Such prohibition will be in addition to the pre-existing provisions of the Plan that preclude the repricing of outstanding stock options and stock appreciation rights without shareholder approval.

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(viii) There will be express authorization for certain adjustments to outstanding awards upon a change in control transaction, including the conversion of performance-based awards into service-only vesting awards upon their assumption in a change in control transaction effected prior to the completion of the applicable performance period.

(ix) There will be express authorization for the plan administrator to implement a non-employee Board member retainer fee deferral program under the Plan that would allow the non-employee Board members the opportunity to elect to convert the Board retainer fee to be earned for a particular year into restricted stock units that defer the issuance of the shares of common stock that vest under those restricted stock units until the individual's cessation of Board service or other permissible date or event under Code Section 409A.

(x) The Plan has been renamed the Incentive Compensation Plan.

The Board adopted the amended and restated Plan by unanimous written consent on April 20, 2010, subject to shareholder approval at the Annual Meeting.

The proposed revisions contemplated by the amended and restated Plan are designed to assure that we will have a sufficient share reserve to fund future equity incentive awards to individuals in our employ or service who are essential to its financial success and long-term growth. In addition, the Plan as so amended and restated will continue to provide us with the flexibility needed to structure awards in a tax efficient manner and in a manner that will attract and retain talented and skilled individuals who have the potential to make significant contributions to our business and our overall growth and development. As indicated more specifically below, shareholder approval of the amended and restated Plan will also constitute approval of the various performance goals upon which specific vesting targets may be established for awards made under the Plan that are intended to qualify as performance-based compensation under Code Section 162(m) and the per participant limitations imposed under the Plan on such awards.

Should the amended and restated Plan not be approved by the shareholders, then the changes summarized in items (i)-(v), (vii) and (x) above will not be implemented. However, the changes summarized in items (vi), (viii) and (ix) above will be implemented, and the Plan as so revised will continue in full force and effect until its scheduled February 22, 2016 expiration date or any earlier termination date in accordance with the provisions of the Plan.

## **Summary Description of the Plan**

The principal terms and provisions of the Plan are summarized below. The summary, however, is not intended to be a complete description of all the terms of the Plan and is qualified in its entirety by reference to the complete text of the Plan. Any shareholder who wishes to obtain a copy of the actual Plan document may do so upon written request to our Corporate Secretary at our principal offices at Four Embarcadero Center, Suite 3700, San Francisco, CA 94111.

*Incentive Programs.* The Plan consists of four separate equity incentive programs: (i) the discretionary grant program, (ii) the stock issuance program, (iii) the incentive bonus program and (iv) the automatic grant program for the non-employee members of our Board of Directors. The principal features of each program are described below.

*Types of Awards.* The various types of equity incentives which may be issued under the Plan (collectively, the Awards ) are as follows: (i) stock options and stock appreciation rights under the discretionary grant program, (ii) stock bonuses and stock issuances pursuant to restricted stock awards, restricted stock units, performance shares and other stock-based awards under the stock issuance program, (iii) cash bonus awards, performance unit awards and dividend equivalent rights under the incentive bonus program (iv) and stock options and restricted stock unit awards to our non-employee Board members under the automatic grant program.

*Administration.* The compensation committee of our Board of Directors will have the exclusive authority to administer the discretionary grant, incentive bonus and stock issuance programs with respect to Awards made to our executive officers and Board members and will also have the authority to make Awards under those programs to all other eligible individuals. However, our Board of Directors may at any time appoint a secondary committee of one or more Board members to have separate but concurrent authority with the compensation committee to make Awards under those programs to individuals other than executive officers and Board members.

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The term plan administrator, as used in this summary, will mean our compensation committee and any secondary committee, to the extent each such entity is acting within the scope of its administrative authority under the Plan.

The compensation committee will have limited discretion under the automatic grant program to determine the number of shares subject to each option grant and restricted stock unit award made under that program, up to the maximum number of shares permissible per grant or award, but all option grants and restricted stock unit awards will otherwise be made in strict compliance with the express terms of that program.

*Eligibility.* Officers and employees, as well as independent consultants and contractors, in our employ or in the employ of our parent or subsidiary companies (whether now existing or subsequently established) will be eligible to participate in the discretionary grant, incentive bonus and stock issuance programs. The non-employee members of our Board of Directors will also be eligible to participate in those programs as well as the automatic grant program. As of March 31, 2010, approximately eleven persons (including three executive officers) were eligible to participate in the discretionary grant, incentive bonus and stock issuance programs, and four non-employee Board members were eligible to participate in those programs and the automatic grant program.

*Securities Subject to Plan.* If the Plan is approved by our shareholders, 1,630,000 shares of our common stock will initially be reserved for issuance over the term of the Plan. Such share reserve will be comprised of the following components: (i) the 750,000 shares initially reserved for issuance under the Plan (which included the number of shares of common stock available for issuance under the predecessor plans on June 28, 2006, including the shares subject to options outstanding at that time under the predecessor plans), and (ii) an additional share increase of 880,000 shares. The shares of common stock issuable under the Plan may be drawn from shares of our authorized but unissued common stock or from shares of our common stock that the Company acquires, including shares purchased on the open market or in private transactions.

As of March 31, 2010, 598,930 shares in the aggregate were subject to outstanding options under the Plan (including 97,030 shares subject to outstanding options granted under the predecessor plans that were transferred to the Plan), 2,000 shares were subject to unvested restricted stock units under the Plan, 7,000 shares had been issued under the Plan, and 1,022,070 shares remained available for future award under the Plan, assuming shareholder approval of the 880,000-share increase that forms part of this proposal.

*Share Counting Provisions.* The number of shares of common stock reserved for award and issuance under the Plan will be reduced: (i) on a one-for-one basis for each share of common stock subject to an Award made under the discretionary grant program or subject to a stock option grant made under the automatic grant program, (ii) on a one-for-one basis for each share of common stock issued pursuant to a Full Value Award made under the stock issuance, incentive bonus and automatic grant programs prior to March 18, 2010 and (iii) by a fixed ratio of 1.59 shares of common stock for each share of common stock issued pursuant to a Full Value Award made under the stock issuance, incentive bonus and automatic grant programs on or after March 18, 2010.

For such purpose, a Full Value Award will be any of the following Awards made under the stock issuance, incentive bonus or automatic grant programs of the Plan that are settled in shares of our common stock: restricted stock awards (unless issued for cash consideration equal to the fair market value of the shares of common stock on the award date), restricted stock units, performance shares, performance units, and any other share-settled awards under the Plan other than (i) stock options and stock appreciation rights issued under the discretionary grant program, (ii) stock options issued under the automatic grant program and (iii) dividend equivalent rights under the incentive bonus program.



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Shares of common stock subject to outstanding Awards made under the Plan (including the options transferred from the predecessor plans) will be available for subsequent issuance under the Plan to the extent those awards expire or terminate for any reason prior to the issuance of the shares of common stock subject to those awards. Such shares will be added back to the number of shares of common stock reserved for award and issuance under the Plan as follows:

For each share of common stock subject to such an expired, forfeited, cancelled or terminated award made under the discretionary grant program (including the options transferred from the predecessor plans) or subject to an option grant made under the automatic grant program, one share of common stock will become available for subsequent award and issuance under the Plan,

For each share of common stock subject to a forfeited or cancelled Full Value Award made under the stock issuance, automatic grant or incentive bonus program prior to March 18, 2010, one share will become available for subsequent award and issuance.

For each share of common stock subject to a forfeited or cancelled Full Value Award made under the stock issuance, automatic grant or incentive bonus program on or after March 18, 2010, 1.59 shares will become available for subsequent award and issuance.

For each unvested share of common stock issued under the discretionary grant or stock issuance program for cash consideration not less than the fair market value per share of common stock on the award date and subsequently repurchased by us, at a price per share not greater than the original issue price paid per share, pursuant to our repurchase rights under the Plan, one share will become available for subsequent award and issuance under the Plan.

There are no net counting provisions in effect under the Plan. Accordingly, the following share counting procedures will apply in determining the number of shares of common stock available from time to time for issuance and award under the Plan:

Should the exercise price of an option be paid in shares of our common stock, then the number of shares reserved for issuance under the Plan will be reduced by the gross number of shares for which that option is exercised, and not by the net number of new shares issued under the exercised option.

Should shares of common stock otherwise issuable under the Plan be withheld by us in satisfaction of the withholding taxes incurred in connection with the exercise, issuance or vesting of an Award, then the number of shares of common stock available for issuance under the Plan will be reduced on the basis of the full number of shares that were issuable under the Award, and not on the basis of the net number of shares actually issued after any such share withholding.

Upon the exercise of any stock appreciation right granted under the Plan, the share reserve will be reduced by the gross number of shares as to which such stock appreciation right is exercised, and not by the net number of shares actually issued upon such exercise.

*Award Limitations.* Awards made under the Plan will be subject to the following per-participant limitations in order to provide the plan administrator with the opportunity to structure one or more of those awards as performance-based compensation under Section 162(m) of the Code:

For awards denominated in shares of our common stock at the time of grant (whether payable in common stock, cash or a combination of both), a participant in the Plan may not receive awards for more than 150,000 shares of our common stock in the aggregate. However, for the calendar year in which such person

first commences service, the foregoing limitation will be increased to 200,000 shares. Such share limitations will be subject to adjustment from time to time for stock splits, stock dividends and similar transactions affecting the number of outstanding shares of our common stock. Shareholder approval of this proposal will also constitute approval of those share limitations for purposes of Section 162(m). Accordingly, such limitations will assure that any deductions to which we would otherwise be entitled upon the exercise of stock options or stock appreciation rights granted under the Plan will not be subject to the \$1 million limitation on the income tax deductibility of compensation paid per executive officer imposed under Section 162(m). In addition, shares issued under the stock issuance and incentive bonus programs

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may also qualify as performance-based compensation that is not subject to the Section 162(m) limitation, if the vesting of those shares is tied to the attainment of the corporate performance milestones discussed below in the summary description of the stock issuance program.

For performance-based awards denominated in cash dollars at the time of grant (whether payable in cash, shares of our common stock, or both), a participant in the Plan may not receive awards that exceed in the aggregate \$1,500,000.00 for each calendar year within the applicable performance measurement period, with such performance period limited to a maximum of 5 years and with pro-ratio based on such dollar limit for any fractional year included within such performance period. Shareholder approval of this proposal will also constitute approval of that \$1,500,000.00 limitation for purposes of Section 162(m). Accordingly, such limitation will assure that any deductions to which we would otherwise be entitled upon the payment of cash bonuses or the settlement of performance units under the incentive bonus plan will not be subject to the \$1 million limitation on the income tax deductibility of compensation paid per executive officer imposed under Section 162(m), to the extent the vesting of those awards is tied to the attainment of one or more of the corporate performance milestones discussed below in the summary description of the stock issuance program.

*ISO Limitation.* The maximum number of shares of common stock which may be issued under the Plan pursuant to options intended to qualify as incentive stock options under the federal tax laws may not exceed 1,630,000 shares in the aggregate (assuming shareholder approval of the 880,000-share increase that forms part of this proposal), subject to adjustment from time to time for stock splits, stock dividends and similar transactions affecting the number of outstanding shares of our common stock.

## **Equity Incentive Programs**

*Discretionary Grant Program.* Under the discretionary grant program, eligible persons may be granted options to purchase shares of our common stock or stock appreciation rights tied to the value of our common stock. The plan administrator will have complete discretion to determine which eligible individuals are to receive such Awards, the time or times when those Awards are to be made, the number of shares subject to each such Award, the vesting schedule (if any) to be in effect for the Award, the maximum term for which the Award is to remain outstanding and the status of any granted option as either an incentive stock option or a non-statutory option under the federal tax laws.

Each granted option will have an exercise price per share determined by the plan administrator, but the exercise price will not be less than one hundred percent of the fair market value of the option shares on the grant date. No granted option will have a term in excess of seven years. The shares subject to each option will generally vest in one or more installments over a specified period of service measured from the grant date. However, one or more options may be structured so that they will be immediately exercisable for any or all of the option shares. The shares acquired under such immediately exercisable options will be subject to repurchase by us, at the lower of the exercise price paid per share or the fair market value per share, if the optionee ceases service prior to vesting in those shares.

Upon cessation of service, the optionee will have a limited period of time in which to exercise his or her outstanding options to the extent exercisable for vested shares. The plan administrator will have complete discretion to extend the period following the optionee's cessation of service during which his or her outstanding options may be exercised and/or to accelerate the exercisability or vesting of such options in whole or in part. Such discretion may be exercised at any time while the options remain outstanding, whether before or after the optionee's actual cessation of service.

The Plan will allow the issuance of two types of stock appreciation rights under the discretionary grant program:

Tandem stock appreciation rights provide the holders with the right to surrender their options for an appreciation distribution from us in an amount equal to the excess of (i) the fair market value of the vested



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shares of our common stock subject to the surrendered option over (ii) the aggregate exercise price payable for those shares.

Stand-alone stock appreciation rights allow the holders to exercise those rights as to a specific number of shares of our common stock and receive in exchange an appreciation distribution from us in an amount equal to the excess of (i) the fair market value of the shares of common stock as to which those rights are exercised over (ii) the aggregate base price in effect for those shares. The base price per share may not be less than the fair market value per share of our common stock on the date the stand-alone stock appreciation right is granted, and the right may not have a term in excess of seven years.

The distribution with respect to any exercised tandem or stand-alone stock appreciation right will be made in shares of our common stock. Stock appreciation rights will remain exercisable for a limited period following the holder's cessation of service, but only to the extent those rights are exercisable at the time of such cessation of service. The plan administrator will have complete discretion to extend the period following the holder's cessation of service during which his or her outstanding stock appreciation rights may be exercised and/or to accelerate the exercisability or vesting of those stock appreciation rights in whole or in part. Such discretion may be exercised at any time while the stock appreciation right remains outstanding, whether before or after the holder's actual cessation of service.

*Repricing Prohibition.* The plan administrator may not implement any of the following repricing/cash-out programs without obtaining stockholder approval: (i) the cancellation of outstanding options or stock appreciation rights in return for new options or stock appreciation rights with a lower exercise price per share, (ii) the cancellation of outstanding options or stock appreciation rights with exercise prices per share in excess of the then current fair market value per share of our common stock for consideration payable in cash, equity securities or in the form of any other award under the Plan, except in connection with a change in control transaction, or (iii) the direct reduction of the exercise price in effect for outstanding options or stock appreciation rights.

*Stock Issuance Program.* Shares may be issued under the stock issuance program subject to performance or service vesting requirements established by the plan administrator. Shares may also be issued as a fully-vested bonus for past services without any cash outlay required of the recipient. Shares of our common stock may also be issued under the program pursuant to restricted stock units which entitle the recipients to receive those shares upon the attainment of designated performance goals or the completion of a prescribed service period or upon the expiration of a designated time period following the vesting of those units, including (without limitation), a deferred distribution date following the termination of the recipient's service with us. Performance shares may also be issued under the program in accordance with the following parameters:

The vesting of the performance shares will be tied to the attainment of corporate performance objectives over a specified performance period, all as established by the plan administrator at the time of the award.

At the end of the performance period, the plan administrator will determine the actual level of attainment for each performance objective and the extent to which the performance shares awarded for that period are to vest and become payable based on the attained performance levels.

The performance shares which so vest will be paid as soon as practicable following the end of the performance period, unless such payment is to be deferred for the period specified by the plan administrator at the time the performance shares are awarded or the period selected by the participant in accordance with the applicable requirements of Internal Revenue Code Section 409A.

Performance shares may be paid in cash or shares of our common stock.

Performance shares may also be structured so that the shares are convertible into shares of our common stock, but the rate at which each performance share is to so convert will be based on the attained level of performance for each applicable performance objective.

The plan administrator has complete discretion under the program to determine which eligible individuals are to receive awards under the stock issuance program, the time or times when those awards are to be made, the form of those awards, the number of shares subject to each such award, the vesting schedule to be in effect for the award, the issuance schedule for the shares which vest under the award and the cash consideration (if any) payable per share.

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In order to assure that the compensation attributable to one or more Awards under the program will qualify as performance-based compensation which will not be subject to the \$1 million limitation on the income tax deductibility of the compensation paid per executive officer which is imposed under Internal Revenue Code Section 162(m), the plan administrator will also have the discretionary authority to structure one or more of those Awards so that the underlying shares of common stock will vest only upon the achievement of certain pre-established corporate performance goals based on one or more of the following criteria: (1) return on total shareholder equity; (2) earnings per share; (3) net income or operating income (before or after taxes); (4) earnings before interest, taxes, depreciation and amortization; (5) earnings before interest, taxes, depreciation, amortization and charges for stock-based compensation, (6) sales or revenue targets; (7) return on assets, capital or investment; (8) cash flow; (9) market share; (10) cost reduction goals; (11) budget comparisons; (12) measures of customer satisfaction; (13) any combination of, or a specified increase in, any of the foregoing; (14) new product development or successful completion of research and development projects; and (15) the formation of joint ventures, research or development collaborations, or the completion of other corporate transactions intended to increase our revenue or profitability or enhance our customer base. In addition, such performance goals may be based upon the attainment of specified levels of our performance under one or more of the measures described above relative to the performance of other entities and may also be based on the performance of any of our business units or divisions or any parent or subsidiary. Performance goals may include a minimum threshold level of performance below which no award will be earned, levels of performance at which specified portions of an award will be earned and a maximum level of performance at which an award will be fully earned. In addition, the performance goals may be subject to adjustment for one or more of the following items: (A) asset impairments or write-downs; (B) litigation or governmental investigation expenses and judgments, verdicts and settlements in connection therewith; (C) the effect of changes in tax law, accounting principles or other such laws or provisions affecting reported results; (D) accruals for reorganization and restructuring programs; (E) any extraordinary or nonrecurring items; (F) items of income, gain, loss or expense attributable to the operations of any acquired business and costs and expenses incurred in connection with mergers and acquisitions; (G) items of income, gain, loss or expense attributable to one or more business operations divested by us or the gain or loss realized upon the sale of any such business or the assets thereof, (H) accruals for bonus or incentive compensation costs and expenses associated with cash-based awards made under the Plan or our other bonus or incentive compensation plans, and (I) the impact of foreign currency fluctuations or changes in exchange rates.

Stockholder approval of this proposal will also constitute approval of the foregoing performance goals for purposes of establishing the specific vesting targets for one or more awards under the Plan that are intended to qualify as performance-based compensation under Section 162(m).

Outstanding awards under the stock issuance program will automatically terminate, and no shares of our common stock will actually be issued in satisfaction of those awards, if the performance goals or service requirements established for such awards are not attained. However, the plan administrator will have the discretionary authority to issue shares of our common stock in satisfaction of one or more outstanding awards as to which the designated performance goals or service requirements are not attained. In no event, however, will any vesting requirements tied to the attainment of performance objectives be waived with respect to awards which were intended at the time of issuance to qualify as performance-based compensation under Section 162(m), except in the event of the participant's death or disability or in connection with a change in control of the company, as described under the heading *General Provisions - Change in Control*.

*Incentive Bonus Program.* Cash bonus awards, performance unit awards and dividend equivalent rights may be awarded under the incentive bonus program. Cash bonus awards will vest over an eligible individual's designated service period or upon the attainment of pre-established performance goals. Performance unit awards will be subject to the following parameters:

A performance unit will represent either (i) a unit with a dollar value tied to the level at which pre-established corporate performance objectives based on one or more performance goals are attained or (ii) a participating interest in a special bonus pool tied to the attainment of pre-established corporate performance objectives based on one or more performance goals. The amount of the bonus pool may vary with the level at which the applicable performance objectives are attained, and the value of each performance unit which becomes due and payable upon the attained level of performance will be determined by dividing



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the amount of the resulting bonus pool (if any) by the total number of performance units issued and outstanding at the completion of the applicable performance period.

Performance units may also be structured to include a service-vesting requirement which the participant must satisfy following the completion of the performance period in order to vest in the performance units awarded with respect to that performance period.

Performance units which become due and payable following the attainment of the applicable performance objectives and the satisfaction of any applicable service-vesting requirement may be paid in cash or shares of our common stock valued at fair market value on the payment date.

Dividend equivalent rights may be issued as stand-alone awards or in tandem with other awards made under the Plan. Each dividend equivalent right award will represent the right to receive the economic equivalent of each dividend or distribution, whether in cash, securities or other property (other than shares of our common stock) which is made per issued and outstanding share of our common stock during the term the dividend equivalent right remains outstanding. Payment of the amounts attributable to such dividend equivalent rights may be made, in cash or shares of our common stock, either concurrently with the actual dividend or distribution made per issued and outstanding share of our common stock or may be made subject to a specified vesting schedule or a deferred payment date. However, any amounts attributable to dividend equivalent rights relating to an award subject to performance-vesting requirements will not vest or become payable prior to the vesting of that award upon the attainment of the applicable performance goals and will, accordingly, be subject to cancellation and forfeiture to the same extent as the underlying award in the event the performance goals are not attained.

The plan administrator has complete discretion under the program to determine which eligible individuals are to receive such awards under the program, the time or times when those awards are to be made, the form of each such award, the performance objectives for each such award, the amount payable at one or more designated levels of attained performance, any applicable service vesting requirements, the payout schedule for each such award and the method by which the award is to be settled (cash or shares of our common stock).

In order to assure that the compensation attributable to one or more awards under the program will qualify as performance-based compensation which will not be subject to the \$1 million limitation on the income tax deductibility of the compensation paid per executive officer which is imposed under Code Section 162(m), the plan administrator also has the discretionary authority to structure one or more awards under the incentive bonus program so that those awards will vest only upon the achievement of certain pre-established corporate performance goals based on one or more of the performance goals described above in the summary of the stock issuance program.

The plan administrator has the discretionary authority at any time to accelerate the vesting of any and all awards outstanding under the incentive bonus program. However, no vesting requirements tied to the attainment of performance objectives may be waived with respect to awards which were intended at the time of issuance to qualify as performance-based compensation under Section 162(m), except in the event of the participant's death or disability or in connection with a change in control as described under the heading *General Provisions - Change in Control*.

*Automatic Grant Program.* Under the automatic grant program, non-employee Board members will receive a series of automatic grants of stock options and restricted stock unit awards over their period of Board service. All grants under the automatic grant program will be made in strict compliance with the express provisions of such program, and shareholder approval of this proposal will also constitute pre-approval of each option grant and restricted stock unit award made under the automatic grant program on or after the date of the Annual Meeting and the subsequent exercise of those options and the subsequent issuance of the shares subject to those restricted stock unit awards in accordance with the terms of the program summarized below.

Two types of awards will be made under the program:

*Initial Awards.* Each individual who first becomes a non-employee member of the Board will at the time of his or her election to the board, receive an option grant to purchase a specified number of shares of our common stock and a restricted stock unit award covering an additional number of shares of our common stock, provided that such individual has not previously been in our employ or employ of any parent or subsidiary

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company. The specific number of shares subject to the initial award will be determined by the compensation committee of our Board of Directors, but will not exceed 10,000 shares for the option component or more than 3,000 shares for the restricted stock unit component.

*Annual Award.* On the date of each annual shareholders meeting, each individual who will continue to serve as a non-employee Board member will automatically be granted an option to purchase a specified number of shares of our common stock and a restricted stock unit award covering an additional number of shares of our common stock, provided such individual has served as a non-employee Board member for at least six (6) months. The specific number of shares subject to the initial award will be determined by the compensation committee of our Board of Directors, but will not exceed 3,000 shares for the option component or more than 1,000 shares for the restricted stock unit component. There will be no limit on the number of such annual awards any one eligible non-employee member of the Board may receive over his or her period of continued service on the Board, and non-employee members of the Board who have previously been in our employ will be eligible to receive one or more such annual awards over their period of service on the Board.

It is currently anticipated that the annual award to the non-employee Board members at the Annual Meeting will be comprise of an option grant for 2,000 shares and a restricted stock unit award for an additional 500 shares.

Each option grant under the program will have an exercise price per share equal to the fair market value per share of our common stock on the grant date and will have a term of seven years, subject to earlier termination following the optionee's cessation of Board service. The option will be immediately exercisable for all of the option shares; however, we may repurchase, at the *lower* of the exercise price paid per share or the fair market value per share, any shares purchased under the option which are not vested at the time of the optionee's cessation of Board service. The shares subject to each initial automatic option grant will vest in four successive equal annual installments upon the optionee's completion of each year of Board service over the four-year period measured from the grant date. The shares subject to each annual automatic option grant made to a continuing Board member will vest upon the earlier of (i) that individual's completion of one year of Board service measured from the grant date or (ii) such individual's continuation in Board service through the day immediately preceding the date of the next annual shareholders meeting following such grant date. However, the shares will immediately vest in full upon the optionee's death or disability while a Board member or upon the occurrence of certain changes in ownership or control.

The option grants under the automatic option grant program will be taxable as non-statutory options under the Federal income tax laws.

The initial restricted stock unit award made to a newly elected or appointed non-employee Board member will vest in a series of four (4) successive equal annual installments upon his or her completion of each year of Board service over the four (4)-year period measured from the award date. Each annual restricted stock unit award made to a continuing non-employee Board member will vest upon his or her continuation in Board service through the earlier of (i) the completion of the one (1)-year period of service measured from the award date or (ii) the individual's continuation in such service capacity through the day immediately preceding the next annual shareholders meeting following such award date. However, each restricted stock unit award held by a non-employee Board member under the automatic grant program will immediately vest in full upon certain changes in control or ownership or his or her cessation of Board service by reason of death or disability. As the restricted stock units vest in one or more installments, the shares of common stock underlying those vested units will be promptly issued.

The plan administrator may implement a non-employee Board member retainer fee deferral program under the Plan that would allow the non-employee Board members the opportunity to elect, prior to the start of each calendar year, to convert the Board retainer fee to be earned for such year into restricted stock units under the stock issuance program that defer the issuance of the shares of common stock that vest under those restricted stock units until their cessation

of Board service or other permissible date or event under Code Section 409A.

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The following table sets forth, as to our Chief Executive Officer, our Chief Financial Officer, our other named executive officers (as identified in the Summary Compensation Table, which appears elsewhere in this proxy statement) and the other individuals and groups indicated, the number of shares of our common stock subject to option grants made under the Plan from January 1, 2009 through March 31, 2010, together with the weighted average exercise price per share in effect for such option grants.

<b>Name and Position</b>	<b>Number of Shares Underlying Options Granted(#)</b>	<b>Weighted Average Exercise Price Per Share(\$)</b>
Ernest A. Bates, M.D.	None	
Ernest R. Bates	None	
Craig K. Tagawa	None	
All current executive officers as a group (3 persons)	None	
Non-employee directors:		
Olin C. Robison	2,000	\$ 2.10