

EARTHSHELL CORP
Form PRE 14A
October 27, 2006
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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 ss. 240.14a-12

EARTHSHELL CORPORATION
(Name of Registrant as Specified in Its Charter)

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

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
 - (1) Title of each class of securities to which transaction applies: Not applicable
 - (2) Aggregate number of securities to which transaction applies: Not applicable
 - (3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined): Not applicable
 - (4) Proposed maximum aggregate value of transaction:
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 - (1) Amount previously paid:
 - (2) Form, Schedule or Registration Statement No.:
 - (3) Filing Party:
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EARTHSHELL CORPORATION

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

TO BE HELD ON DECEMBER [], 2006

The 2006 Annual Meeting of Stockholders of EarthShell Corporation (the Company) will be held at [] in Baltimore, Maryland on December [], 2006 at 10:00 a.m. Eastern Daylight Time, for the purposes of:

- (1) Electing five directors to serve until the 2007 annual meeting of stockholders and until their successors are elected and have qualified;
- (2) Approving the Amendment of the Company s Amended and Restated Certificate of Incorporation to increase the authorized common stock;
- (3) Approving an amendment to the Company s 1995 Stock Incentive Plan increasing the number of shares of Common Stock available for awards and adjusting the annual non-employee director option award;
- (4) Approving any adjournments or postponements of the meeting for the purpose of soliciting additional proxies; and
- (5) Transacting such other business as may properly come before the meeting and at any adjournment or postponement thereof.

The Board of Directors has fixed the close of business on [] 2006 as the record date for the determination of stockholders who are entitled to receive notice of, and to vote at, the Annual Meeting and any adjournments or postponements thereof. You are cordially invited to attend the meeting in person. **Whether or not you expect to attend, you are urged to vote your shares via the Internet or by telephone at any time. Please follow the instructions on the enclosed proxy card. To vote by mail, please sign and date the enclosed proxy and return it as promptly as possible in the enclosed self-addressed, postage-prepaid envelope.** If you attend the Annual Meeting and wish to vote in person, your proxy will not be used as long as you have notified the Secretary in writing of your intention to revoke your proxy before it has been voted.

By Order of the Board of Directors

D. Scott Houston
Secretary

Baltimore, Maryland
_____, 2006

EARTHSHELL CORPORATION

**PROXY STATEMENT
FOR
ANNUAL MEETING OF STOCKHOLDERS
DECEMBER [] 2006**

This Proxy Statement is furnished to the stockholders of EarthShell Corporation, a Delaware corporation (the "Company"), in connection with the solicitation of proxies by the Board of Directors of the Company for use at the 2006 Annual Meeting of Stockholders (the "Annual Meeting") to be held at _____ in Baltimore, Maryland, at 10:00 a.m. Eastern Daylight Time, on December [], 2006, and at any and all adjournments or postponements thereof. This Proxy Statement and the form of proxy is being mailed on or about [], 2006 to all stockholders entitled to vote at the Annual Meeting.

The cost of the solicitation of proxies will be borne by the Company. In addition to solicitation by mail, directors and officers of the Company, without receiving any additional compensation, may solicit proxies personally or by telephone or telegraph. The Company will request brokerage houses, banks, and other custodians or nominees holding stock in their names for others to forward proxy materials to their customers or principals who are the beneficial owners of shares and will reimburse them for their expenses in doing so. The Company has retained the services of [] to assist in the solicitation of proxies from brokerage houses, banks and other custodians or nominees holding stock in their names for others for a fee estimated at approximately \$[] plus certain expenses. The costs of such solicitation will be paid by the Company.

Record Date and Voting

On [], 2006, the record date for the determination of stockholders entitled to notice of, and to vote at, the Annual Meeting (the "Record Date"), the Company had [] shares of common stock, par value \$0.01 per share ("Common Stock"), outstanding. Presence at the Annual Meeting, in person or by proxy, of a majority of the outstanding shares of Common Stock will constitute a quorum for the transaction of business at the Annual Meeting or any adjournment thereof. Abstentions or broker non-votes are counted for purposes of determining the presence of a quorum for transaction of business. With regard to the election of directors, votes may be cast in favor or withheld; votes that are withheld will be excluded entirely from the vote and will have no effect. Broker non-votes are shares which are represented at the Annual Meeting which a broker or nominee has indicated it does not have discretionary authority to vote.

Each such share of Common Stock is entitled to one vote on all matters properly brought before the meeting. The vote of a plurality of the shares cast in person or by proxy is required to elect a nominee for director. With respect to the election of each director at the Annual Meeting, each holder of Common Stock is entitled to vote the number of shares owned by such stockholder. The nominees who receive the greatest number of votes shall be elected to fill the vacancies on the Board. Stockholders are not permitted to cumulate their shares of Common Stock for the purpose of electing directors or otherwise.

A list of shareholders entitled to vote at the Annual Meeting will be open to the examination of any shareholder, for any purpose germane to the Annual Meeting, during normal business hours for a period of ten days before the Annual Meeting at our corporate offices at 1301 York Road, Suite 200, Lutherville, Maryland 21093, and at the time and place of the Annual Meeting.

Vincent J. Truant and D. Scott Houston, the persons named as proxy holders on the proxy card accompanying this Proxy Statement, were selected by the Board of Directors to serve in that capacity. Messrs. Truant and Houston are both officers and directors of the Company.

To vote by mail, mark your vote on the enclosed proxy card, then follow the directions on the card. To vote your proxy using the Internet or by telephone, see the instructions on the enclosed proxy card. The proxy committee will vote your shares according to your directions. If you do not mark any selections, your shares will be voted as recommended by the Board of Directors.

With respect to any other business, which may properly come before the Annual Meeting and be submitted to a vote of stockholders, proxies received by the Board of Directors will be voted in accordance with the best judgment of the designated proxy holders. Under the Company's Bylaws, stockholder proposals and nominations for persons for elections to the Board, other than those made by or at the direction of the Board, may be made at the Annual Meeting only pursuant to a timely notice in writing delivered or mailed to the Secretary of the Company at the Company's offices at 1301 York Road, Suite 200, Lutherville, Maryland 21093 not later than the tenth day following the first public announcement of the Annual Meeting. A stockholder may revoke his or her proxy at any time before exercise by delivering to the Secretary of the Company a written notice of such revocation, by filing with the Secretary of the Company a duly executed proxy bearing a later date, or by voting in person at the Annual Meeting, provided that, in accordance with the Company's Bylaws, the stockholder has delivered to the Secretary a written notice of the stockholder's intention to revoke the proxy and vote in person prior to the voting of the proxy.

PROPOSAL NO. 1

ELECTION OF DIRECTORS

The Board of Directors of the Company is currently comprised of five members, all of whom will be standing for re-election. All directors are elected each year at the annual meeting of stockholders. In the absence of instructions to the contrary, the persons named as proxy holders in the accompanying proxy intend to vote in favor of the election of the nominees designated below to serve until the next annual meeting of stockholders and until their respective successors shall have been elected and qualified. The Board of Directors expects that each of the nominees will be available to serve as a director. If any nominee should become unavailable for election, the shares of Common Stock represented by the enclosed proxy may (unless such proxy contains instructions to the contrary) be voted for such other person or persons as may be determined by the proxy holders. Each of the nominee directors have been nominated by the Board of Directors.

The following table sets forth the name and age of each director nominated for election at the Annual Meeting, the year the director was first elected and his or her position with the Company:

Name	Age	Position	Director Since
Vincent J. Truant	58	Director, Chairman of the Board, and Chief Executive Officer	2005
D. Scott Houston	52	Director and Chief Financial Officer	2005
Hamlin M. Jennings	58	Director	2003
Walker Rast	70	Director	2003
Michael C. Gordon	70	Director	2005

The following is a biographical summary of the experience of each of the director nominees:

Director Nominees

Vincent J. Truant has served as the Company's Chief Executive Officer since September 1, 2005, as President since 2002 and as a Director since July 2005. In February 2006, Mr. Truant was also elected Chairman of the Board of EarthShell. From May 15, 2002 to August 31, 2005, Mr. Truant served as the Company's President and Chief Operating Officer. From March 2001 to May 2002, Mr. Truant served as Senior Vice President and Chief Marketing Officer of the Company. From October 1999 to March 2001, and from March 1999 to October 1999, respectively, he served as Senior Vice President and as Vice President of Marketing, Environmental Affairs and Public Relations, and from April 1998 to March 1999 as Vice President of Marketing and Sales. During a prior fifteen (15) year tenure at Sweetheart Cup Company (Sweetheart), Mr. Truant served as Vice President and General Manager for the National Accounts Group and the McDonald's Corporation Strategic Business Units. Before joining Sweetheart, Mr. Truant was engaged in both domestic and international marketing assignments for Philip Morris Inc. and its subsidiary, Miller Brewing Company, as well as Eli Lilly & Company.

Michael C. Gordon was appointed to the Board of Directors in June 2005. Mr. Gordon is currently the Director of SEC Services for Gumbiner Savett Inc., Certified Public Accountants and Business Advisors. From 1990 through 2001, Mr. Gordon was an audit partner with BDO Seidman, where he was in charge of the audit department of the Los Angeles office. From 1977 to 1990, he was an audit partner with Laventhol and Horwath where he was also in charge of the audit department of the Los Angeles office. Prior to 1977, he was an audit partner with Arthur Young & Company. Mr. Gordon has over forty years of public accounting, SEC, and financial reporting experience. The Board of Directors has determined that Mr. Gordon qualifies as an audit committee financial expert as that term is defined in Item 401(h)(2) of Regulation S-K in the Securities Exchange Act of 1934. Mr. Gordon is serving as Chairman of the Audit Committee.

D. Scott Houston has served as a Director of the Company since July 2005, as the Company's Chief Financial Officer since October 1999, and as the Company's Secretary since December 1999. From January to October 1999, Mr. Houston served as Senior Vice President of Corporate Planning and Assistant Secretary. From July 1993 until January 1999, Mr. Houston served as Chief Financial Officer. From August 1986 until joining the Company, he held various positions with E. Khashoggi Industries and its affiliates, including Chief Financial Officer and Vice President of CTC from 1986 to 1990. From 1984 to 1986, Mr. Houston operated Houston & Associates, a consulting firm. From July 1980 until September 1983, Mr. Houston held various positions with the Management Information Consulting Division of Arthur Andersen & Co., an international accounting and consulting firm.

Hamlin M. Jennings has served as a Director of the Company since January 2003. Since 1987, Dr. Jennings has been a Professor in the Civil and Environmental Engineering Department and the Materials Sciences and Engineering Department at Northwestern University. Prior to his appointment at Northwestern, Dr. Jennings worked at the National Institute of Standards and Technology, Imperial College London, and the University of Cape Town. He is a fellow of the Institute of Materials in the United Kingdom and Fellow of the American Ceramic Society. Additionally, Dr. Jennings is owner and President of Evanston Materials Consulting Corporation, founded in 1997, which specializes in cement-based materials and coatings. Dr. Jennings holds 12 patents, is the associate editor of two journals and has published over 120 scientific papers.

Walker Rast has served as a Director of the Company since September 2003. Mr. Rast is currently a business consultant and a member of the Educational Foundation Board of the University of South Carolina and a member of the Advisory Board of the College of Engineering and Information Technology. From 1994 to the present, Mr. Rast was a founding member and major stockholder in two startup companies using technology jointly developed with the University of South Carolina. One company has developed sea and inland water purification with zero waste discharge. The other is developing a new

method for hydrogen production. From 1987 to 1994, Mr. Rast was a member of the Executive Board of Directors of Royal Packaging Industries Van Leer, a worldwide packaging company based in the Netherlands. From 1979 to 1987, Mr. Rast was Chairman and CEO of Keyes Fibre Company (now known as The Chinet Company), first an operating group of Arcata Corporation and then of Royal Packaging Industries Van Leer. Mr. Rast held various domestic and international executive positions with Van Leer and Arcata Corporation for over ten years, and was previously with U.S. Gypsum Corporation for eleven years.

Director Nominating Process

The Board’s policy with respect to director nominations is to assess the appropriate size of the Board, and whether any vacancies are expected due to retirement or otherwise. In the event that vacancies are anticipated, or otherwise arise, the Board considers various potential candidates for director. The Board also considers properly submitted stockholder nominations for candidacy for director.

The Board utilizes a variety of methods for identifying and evaluating director candidates. Candidates may come to the attention of the Board through its current members, stockholders or other persons. These candidates are evaluated at regular or special meetings, and may be considered at any point during the year. In evaluating all nominees, the Board considers a variety of criteria, including business experience and skills, independence, judgment, integrity, the ability to commit sufficient time and attention to Board activities and the absence of potential conflicts with the Company’s interests

Any stockholder nominations proposed for consideration by the Board should include the nominee’s name and qualifications for Board membership and should be addressed to EarthShell Corporation, 1301 York Road, Suite 200, Lutherville, Maryland 21093, Attention: Board of Directors. Following verification of the stockholder status of persons recommending candidates to the Board, recommendations are aggregated and considered by the Board at a regularly scheduled meeting. If any materials are provided by a stockholder in connection with the nomination of a director candidate, such materials are forwarded to the Board.

Committees of the Board of Directors

At the annual meeting of the Board in July 2005, the Company reorganized the Committees of the Board. Currently, the Board maintains three standing committees: the Audit Committee, the Compensation Committee, the Corporate Governance and Nominating Committee. The Board has written charters for each of its committees.

Director nominees are recommended to the full Board by the Corporate Governance and Nominating Committee with input from management. The committees are presently comprised of the following Directors:

Audit Committee		Compensation Committee	Corporate Governance & Nominating Committee
Mr. Gordon (Chair)		Dr. Jennings (Chair)	Mr. Rast (Chair)
Mr. Rast		Mr. Gordon	Dr. Jennings
Dr. Jennings		Mr. Rast	Mr. Gordon

Executive Committee

The Executive Committee was dissolved at the July 2005 annual meeting of the Board in connection with the reorganization of Board and the Board committees. Prior to being dissolved, the Executive Committee held frequent meetings in 2004 and in 2005, and at times took action by unanimous written consent in lieu of meetings. The primary function of the Executive Committee was to perform all of the

duties otherwise vested in the Board when the Board is not in session, except for the following matters which were not delegated to the Executive Committee: (a) declaring cash or stock dividends or distributions to stockholders of the Company; (b) taking action on matters otherwise specifically delegated to other committees of the Board of Directors; (c) amending or repealing the Certificate of Incorporation or Bylaws of the Company, or adopting new ones; (d) approving a plan of merger, acquisition or divestiture or sale, lease or exchange of substantially all of the business, properties or assets of the Company; (e) authorizing or approving the issuance or sale of shares of stock of the Company; (f) authorizing the Company to perform or make a contract or commitment that requires a financial commitment by the Company exceeding the applicable amount budgeted under the operating budget or capital budget approved by the Board, if such contract or commitment, together with any other such contract or commitment, involves a payment by the Company of more than \$1 million in the aggregate; and (g) electing or removing officers, directors or members of any committee of the Board. The Executive Committee functioned according to a written charter.

Compensation Committee

The Compensation Committee held two (2) meetings in 2005. At the annual meeting of the Board in July 2005, the Stock Options Committee was dissolved and the functions of that committee were assumed by the Compensation Committee. Prior to August 2005, the functions of the Compensation Committee included: (a) reviewing and recommending to the Board of Directors the annual base salary, bonus and other benefits for each of the senior executive officers of the Company; (b) reviewing and commenting on new executive compensation programs that the Company proposes to adopt; (c) periodically reviewing the results of the Company's executive compensation and perquisite programs to ensure that they are properly coordinated to yield payments and benefits that are reasonably related to executive performance; (d) helping to ensure that a significant portion of executive compensation is reasonably related to the long-term interests of the stockholders; (e) participating in the preparation of certain portions of the Company's annual proxy statement; (f) hiring a compensation expert to provide independent advice on compensation levels, if necessary; and (g) helping to ensure that the Company undertakes appropriate planning for management succession and advancement.

On August 11, 2005, a new charter was adopted for the Compensation Committee. As outlined in the new charter, the functions of the Compensation Committee include: (a) oversee the Company's overall compensation structure, policies and programs, and assess whether the Company's compensation structure establishes appropriate incentives for management and employees; (b) review and approve corporate goals and objectives relevant to the compensation of the Chief Executive Officer (the CEO), evaluate the CEO's performance in light of those goals and objectives, and either as a committee or together with the other independent directors (as directed by the Board), determine and approve the CEO's compensation level based on this evaluation; (c) administer and make recommendations to the Board with respect to non-CEO compensation and the Company's incentive-compensation and equity-based compensation plans; (d) review and recommend to the Board the annual base salary, bonus, and other benefits for the executive officers of the Company with the goal of ensuring that a significant portion of executive compensation is reasonably related to the long-term interests of the stockholders; (e) approve stock option and other stock incentive awards for executive officers; (f) review and approve the design of other benefit plans pertaining to executive officers; (g) review and recommend employment agreements and severance arrangements for executive officers, including change-in-control provisions, plans or agreements; (h) approve, amend or modify the terms of any compensation or benefit plan that does not require shareholder approval; (i) review periodically succession plans relating to positions held by executive officers, and make recommendations to the Board regarding the selection of individuals to fill these positions; (j) annually evaluate the performance of the Committee and the adequacy of the committee's charter; and (k) produce a Committee report on executive compensation as required by the Securities and

Exchange Commission (the SEC) to be included in the company's annual proxy statement filed with the SEC. The Compensation Committee Charter is included in Appendix A to this proxy statement.

Audit Committee

The Audit Committee held four meetings in 2005. Previous to August 11, 2005 the functions of the Audit Committee included: (a) engaging an accounting firm to act as the Company's independent external auditor (the Auditor); (b) determining the Auditor's compensation, the proposed terms of its engagement, its independence from the Company and its performance during each year of its engagement; (c) reviewing the Company's annual financial statements and significant disputes, if any, between management of the Company and the Auditor that arise in connection with the preparation of those financial statements; (d) reviewing the results of each external audit; (e) reviewing the procedures employed by the Company in preparing published quarterly financial statements and related management commentaries; (f) reviewing any major changes proposed to be made in auditing and accounting principles and practices in connection with the Company's financial statements; (g) reviewing the adequacy of the Company's internal financial controls; and (h) if the Company appoints a Director of Internal Audit, meeting periodically with that person to evaluate compliance with the foregoing duties.

On August 11, 2005, a new charter was adopted for the Audit Committee. As outlined in the new charter, the functions of the Audit Committee include: (a) oversee the Company's accounting and financial reporting processes and the audits of the Company's financial statements; engaging an accounting firm to act as the Company's Auditor; determining the Auditor's compensation, the proposed terms of its engagement, its independence from the Company and its performance during each year of its engagement; (b) oversee the Company's compliance with legal and regulatory requirements; (c) oversee the Auditor's qualifications and independence; (d) oversee the performance of the Company's internal audit function and Auditor; (e) oversee the Company's system of disclosure controls and system of internal controls; and (f) prepare the report required by the rules of the SEC to be included in the Company's annual proxy statement. The Audit Committee Charter is included as Appendix B to this proxy statement.

The Company's Audit Committee is to be comprised of at least three independent directors. The Committee is currently comprised of Messrs. Gordon, Jennings and Rast, each of whom is an independent Director within the meaning of the Nasdaq Stock Market listing standards. Mr. Gordon serves as Chairman of the Audit Committee. The Board has determined that Mr. Gordon is an audit committee financial expert as that term is defined in Item 401(h)(2) of Regulation S-K in the Securities Exchange Act of 1934, as amended.

Stock Option Committee

The Stock Option Committee was dissolved in connection with the reorganization of the Board and the committees of the Board at the annual meeting of the Board in July 2005. The functions of the Stock Option Committee are now carried out by the Compensation Committee, as outlined above. Prior to being dissolved, the Stock Option Committee held one meeting in 2005. The Stock Option Committee was responsible for administering the Company's 1994 Stock Option Plan and 1995 Stock Incentive Plan (collectively, the Plans) including, without limitation, the following: (a) adopting, amending and rescinding rules relating to the Plans; (b) determining who may participate in the Plans and what awards may be granted to such participants; (c) granting awards to participants and determining the terms and conditions thereof, including the number of shares of common stock issuable pursuant to the awards; (d) determining the terms and conditions of options automatically granted to directors pursuant to the Plans; (e) determining whether and the extent to which adjustments are required pursuant to the anti-dilution provisions of the Plans; and (f) interpreting and construing the Plans and the terms and conditions of any awards granted thereunder.

Conflicts Committee / Corporate Governance & Nominating Committee

At the annual meeting of the Board in July 2005, the Conflicts Committee was dissolved and a new Corporate Governance and Nominating Committee was organized. The Corporate Governance & Nominating Committee held three (3) meetings in 2005. The functions of the Conflicts Committee included reviewing potential related party or conflict of interest transactions to: (a) determine whether each such transaction is on at least as favorable terms to the Company as might be available from other third parties, (b) determine whether such transactions are reasonably likely to further the Company's business activities and interests, (c) determine whether the process by which the decision to enter into such transactions was approved or ratified and is fair, (d) help ensure that all such transactions are disclosed in the Company's filings with the SEC as necessary and (e) if necessary, retain an independent expert to determine the advisability of the Company's entering into such transactions, and to determine fair terms for such transactions.

A charter for the Corporate Governance and Nominating Committee was adopted on August 11, 2005. The functions of the Corporate Governance and Nominating Committee include: (a) identifying qualified individuals to become Board members; (b) determining the composition of the Board and its committees; (c) considering questions of possible conflicts of interest; (d) developing and implementing the Company's corporate governance guidelines; and (e) monitoring a process to assess Board effectiveness. The Corporate Governance & Nominating Committee Charter is included as Appendix C to this proxy statement.

Board and Committee Attendance

The Board of Directors held twelve (12) meetings in 2005. All Directors attended at least seventy-five percent of the Board meetings and the meetings of the Committees on which they served in 2005.

Code of Ethics

The Company has adopted a Code of Ethics that applies to all Directors, officers and employees, including the Chief Executive Officer, Chief Financial Officer and Principal Accounting Officer of the Company. The Company has posted its Code of Ethics on its website at www.earthshell.com. The Company intends to satisfy the disclosure requirement under Item 5.05 of Form 8-K regarding an amendment to, or a waiver from, a provision of its Code of Ethics that applies to the Company's Principal Executive Officer, Principal Financial Officer, Principal Accounting Officer or Controller, or persons performing similar functions, and that relates to an element enumerated in Item 406(b) of Regulation S-K by posting such information on its website.

Independent Auditors

The Audit Committee pre-approved the engagement of Farber, Hass, Hurley & McEwen, LLP to provide both audit and tax services for the fiscal year ended December 31, 2005, including the quarterly reviews for the three quarters of 2005. Farber, Hass, Hurley & McEwen, LLP provided no other audit services, audit-related services, tax services or permitted non-audit services for and during the fiscal year ending 2005. The Audit Committee adopted a pre-approval policy relating to audit services for all audit-related services, tax services and non-audit services to be performed by its auditors from 2004 onward.

During the fiscal years ended December 31, 2005 and 2004, the following audit, audit-related, tax and non-audit fees were incurred by the Company:

Audit Fees. For the year ended December 31, 2005, Farber & Hass LLP charged the Company an aggregate of approximately \$94,200 for professional services rendered for the 2005 audit of the Company's

financial statements and the review of the financial statements included in the Company's Quarterly Reports on Form 10-Q for the three quarters of 2005.

All Other Fees. During the year ended December 31, 2005, the Company incurred fees of \$8,750 for tax return preparation.

Audit Committee Report

The Audit Committee reviews the Company's financial reporting process on behalf of the Board of Directors. Management has the primary responsibility for the financial statements and the reporting process including the internal control system. The Company's independent auditors are responsible for expressing an opinion on the conformity of our audited financial statements to generally accepted accounting principles.

In this context, the Audit Committee has reviewed and discussed the audited financial statements with management and the independent auditors, and has also discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61 (Communication with Audit Committees). The Audit Committee also received from the independent auditors the written disclosures required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees), and discussed with them their independence from the Company and its management. The Audit Committee has further considered whether, and determined that, the independent auditors provision of non-audit services to the Company is compatible with the firm's independence.

In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005 for filing with the Securities and Exchange Commission.

Submitted by the Audit Committee:
Michael C. Gordon
Hamlin Jennings
Mr. Walker Rast

The above report of the Audit Committee shall not be deemed incorporated by reference by any general statement incorporating by reference this Proxy Statement into any filing under the Securities Act of 1933 or under the Securities Exchange Act of 1934, except to the extent that the Company specifically incorporates this information by reference, and shall not be deemed filed under such Acts.

Compensation of Directors

The Board pays to each non-employee director an annual retainer fee of \$20,000, payable quarterly, plus a fee of \$1,000 for each regular meeting attended in person and \$500 for telephonic board meetings. Committee chairpersons receive an additional \$1,000 per quarter for their committee service except for the audit committee chairman, who receives \$3,000 per quarter. All of the directors, except for Mr. Truant and Mr. Houston, are currently considered to be non-employee directors of the Company.

The 1995 Stock Incentive Plan currently provides that each non-employee director automatically be granted options to purchase 25,000 shares of the Company's Common Stock, effective at the conclusion of each annual meeting. All such stock options (i) vest ratably at 25% at the end of each calendar quarter following the grant, provided the director holding the options continues to serve as a director at the end of each such quarter, and (ii) have an exercise price equal to the fair market value of the underlying shares, which is defined in the 1995 Stock Incentive Plan as the closing trading price on the day before such annual meeting.

In April 2004, based on the financial condition of the Company, the Board of Directors unanimously agreed to defer the payment of the director fees discussed above until such time as the financial condition of the Company improves. As an accommodation to the Company, the Directors unanimously agreed to convert their accrued deferred fees through September 30, 2006 in the amount of \$23,000 to common stock.

In June 2005, the Board granted to each of the Company's non-employee directors who had served during the previous year 10,000 restricted shares of the Company's common stock as a bonus in recognition for their willingness to defer their cash compensation since 2004. In June, 2005, Mr. Gordon was appointed to the Board to fill the vacancy created by the resignation of Dr. Roland. Mr. Gordon received an initial grant of 10,000 restricted shares of the Company's common stock.

Proposal #3 herein, if approved, will increase the number of options to purchase common stock which are automatically granted to the non-employee directors each year from 25,000 to 45,000 shares.

PROPOSAL NO. 2

AMENDMENT OF THE COMPANY'S CERTIFICATE OF INCORPORATION TO INCREASE THE NUMBER OF AUTHORIZED SHARES

The Board of Directors has approved and is hereby soliciting stockholder approval of an amendment to the Amended and Restated Certificate of Incorporation of the Company to (i) increase the number of shares of Common Stock the Company is authorized to issue from 40,000,000 to 80,000,000 and in connection therewith (ii) to increase the total number of shares of all classes of stock that the Company is authorized to issue from 50,000,000 to 90,000,000. The full text of the proposed amendment to the Amended and Restated Certificate of Incorporation is set forth below (the "Amendment"). The Company is currently authorized to issue 40,000,000 shares of Common Stock and 10,000,000 shares of preferred stock, par value \$0.01 per share ("Preferred Stock"). If the stockholders approve this proposal, the Board of Directors will have the authority, in its sole discretion, to file such an amendment at any time after the Annual Meeting.

Purposes and Effects of the Proposed Amendments

The Amendment would increase the number of shares of Common Stock the Company is authorized to issue from 40,000,000 to 80,000,000. The additional 40,000,000 shares would become a part of the existing class of Common Stock and, if and when issued, would have the same rights, privileges and preferences as the shares of Common Stock presently issued and outstanding. On September 30, 2006, 20,288,591 shares of Common Stock were issued and outstanding and held of record by 1,200 stockholders of record.

The Board of Directors believes that the increase in the number of authorized shares of common stock at this time will provide the Company with needed flexibility to execute its business plans and previously announced plans to raise additional capital by providing an adequate number of authorized but unissued shares of Common Stock available for issuance to new or existing investors. The additional shares would also be available for issuance under the Company's 1995 Stock Incentive Plan, to facilitate potential acquisitions and for general corporate and working capital purposes, without the expense or delay attendant in seeking stockholder approval at any special or annual meeting (except as may be required by law or by applicable stock exchange rules).

The failure to approve the proposal may limit the Company's ability to obtain needed capital to finance its working capital and capital expenditure needs and may prevent the Company from executing business activities and initiatives proposed by management and approved by the Board of Directors. If this proposal is approved, prior to any issuance of equity securities (or securities convertible into or

exchangeable for equity securities), the Board of Directors will consider factors including, among others, management's proposed business initiative, the then current market price of the Common Stock, the proposed offering price of the equity securities, the potential dilution to Company stockholders, the working capital needs of the Company, and the terms and availability of alternative sources of financing.

The issuance of additional shares of Common Stock might dilute, under certain circumstances, the ownership and voting rights of the current stockholders of the Company. The proposed increase in the number of shares of Common Stock that the Company is authorized to issue is not intended to inhibit a change in control of the Company. The availability for issuance of additional shares of Common Stock could, however, discourage, or make more difficult, efforts to obtain control of the Company. For example, the issuance of shares of Common Stock in a public or private sale, merger or similar transaction would increase the number of outstanding shares, thereby possibly diluting the interest of a party attempting to obtain control of the Company. The Company is not aware of any pending or threatened efforts to acquire control of the Company. While the Company is currently considering issuing both equity and debt securities to provide needed working capital, the Company has no present commitments or agreements to issue additional shares of Common Stock other than with respect to currently reserved shares, in connection with transactions in the ordinary course of the Company's business or shares which may be issued under the Company's 1995 Stock Incentive Plan. Other than increasing the number of authorized shares of the Company's Common Stock, the proposal to increase the authorized shares of Common Stock will not affect the rights, preferences or privileges of the Company's stockholders. However, the actual issuance of additional Common Stock by the Company would reduce each existing stockholder's proportionate ownership of the Company's equity.

Amendments to Certificate of Incorporation

If approved, Article V, Section 1 of the Certificate of Incorporation would be amended and restated substantially as follows:

Number of Authorized Shares. The Corporation shall be authorized to issue two classes of shares of stock to be designated, respectively, Common Stock and Preferred Stock. The total number of shares of all classes of stock that the Corporation shall have the authority to issue is Ninety Million (90,000,000) shares, consisting of Eighty Million (80,000,000) shares of Common Stock, par value \$0.01 per share, and Ten Million (10,000,000) shares of Preferred Stock, par value \$0.01 per share.

Vote Required

Approval of Proposal No. 2 requires the affirmative vote of a majority of the shares of the Company's Common Stock entitled to notice of, and to vote at, the Annual Meeting. Abstentions and broker non-votes will be counted as a vote against this proposal.

The Board of Directors believes that approval of Proposal No. 2 is in the best interests of the Company for the reasons stated above.

THEREFORE, THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS A VOTE FOR APPROVAL OF PROPOSAL NO. 2.

PROPOSAL NO. 3

AMENDMENT OF THE COMPANY'S 1995 STOCK INCENTIVE PLAN TO INCREASE THE NUMBER OF SHARES OF COMMON STOCK AVAILABLE FOR AWARDS THEREUNDER BY 6,250,000 SHARES AND ADJUST THE ANNUAL AUTOMATIC OPTION AWARD TO NON-EMPLOYEE DIRECTORS

At the Annual Meeting, the stockholders will be asked to approve an amendment to the Company's 1995 Stock Incentive Plan (the 1995 Plan) in order to increase the number of shares of Common Stock

available thereunder from 1,250,000 to 7,500,000 shares and to approve an adjustment in the annual automatic option award to non-employee directors.

The Board of Directors has approved and is hereby soliciting stockholder approval of an amendment to the 1995 Plan in the form set forth in Appendix D to the Proxy Statement.

The Company has utilized stock options granted pursuant to the 1995 Plan to attract, retain and motivate its employees, directors and consultants by providing for or increasing their proprietary interests in the Company. Under the 1995 Plan, every employee, director and consultant of the Company, or any of its subsidiaries, is eligible to be considered for the grant of awards. The 1995 Plan had a ten year term, which was extended by the Board in 2005 for two more years, to terminate in November 2007.

A total of 1,250,000 shares of Common Stock are currently reserved for issuance under the 1995 Plan. As of the Record Date, no shares of Common Stock remained available for issuance under the 1995 Plan. The Board of Directors believes that the availability of sufficient number of shares available for issuance under the 1995 Plan is integral to attract, retain and motivate the qualified employees that are fundamental to the success of the Company. Subject to stockholder approval, in October 2006, the Board of Directors approved an increase of 6,250,000 shares of Common Stock issuable under the 1995 Plan, which, if approved by the stockholders, would increase the total shares reserved for issuance under the 1995 Plan from 1,250,000 shares to 7,500,000 shares.

Summary of the 1995 Plan

The purpose of the 1995 Plan is to enable the Company to attract, retain and motivate its employees and consultants by providing for or increasing the proprietary interests of such employees and consultants in the Company and to enable the Company to attract, retain and motivate its non-employee directors and further align their interests with those of the Company's stockholders by providing for or increasing the proprietary interest of such directors in the Company.

Any person who is a director, employee or consultant to the Company or any of its subsidiaries, including any director who is also such an employee, is eligible to be considered for the grant of awards under the 1995 Plan. The 1995 Plan also currently provides for the automatic grant of options to non-employee directors of the Company. As of the Record Date, three employees (including two employee directors) and three non-employee directors were participating in the 1995 Plan.

The maximum number of shares of Common Stock that may currently be issued pursuant to all awards (including incentive stock options or ISOs) granted under the 1995 Plan is 1,250,000, subject to certain anti-dilution adjustments. The maximum number of shares of Common Stock that may currently be issued pursuant to ISOs granted under the 1995 Plan is also 1,250,000. Under the proposed amendment to the 1995 Plan, the maximum number of shares that may be issued pursuant to awards (including ISOs) granted under the 1995 Plan would be increased to 7,500,000, and the maximum number of shares of Common Stock that may be issued pursuant to ISOs is 7,500,000.

No employee may be granted awards under the 1995 Plan with respect to more than 500,000 shares of Common Stock during any calendar year, subject to certain anti-dilution adjustments. This limitation is intended to satisfy the requirements of Section 162(m) of the Internal Revenue Code of 1986, as amended (the Code) so that compensation attributable to awards under the 1995 Plan qualifies as performance-based compensation under Section 162(m) of the Code. In addition, non-employee directors of the Company are currently entitled to receive automatic option grants to purchase 25,000 shares of Common Stock on an annual basis, which are granted on the date of each annual meeting of the stockholders. Under the proposed amendment to the Plan, the non-employee directors will be entitled to receive an automatic option grant to purchase 45,000 shares of the Company's common stock on an annual basis, which options

will be granted on the date of the annual meeting or on the one year anniversary of the previous year's annual meeting, whichever occurs earlier.

The 1995 Plan is administered by The Compensation Committee (the Committee) of the Board of Directors. The Committee is authorized to enter into any type of arrangement with an eligible employee that, by its terms, involves or might involve the issuance of (i) Common Stock or (ii) a derivative security with an exercise or conversion privilege at a price related to the Common Stock or with a value derived from the value of the Common Stock. Awards under the 1995 Plan are not restricted to any specified form or structure and may include arrangements such as sales or bonuses of stock, restricted stock, stock options, reload stock options, stock purchase warrants, other rights to acquire stock, securities convertible into or redeemable for stock, stock appreciation rights, phantom stock, dividend equivalents, performance units or performance shares. An award may consist of one such arrangement or two or more such arrangements in tandem or in the alternative. Any stock option granted to an employee may be an ISO or a nonqualified stock option.

Subject to the provisions of the 1995 Plan, the Committee is authorized and empowered to administer the 1995 Plan, including, without limitation: (i) adopting, amending and rescinding rules and regulations relating to the 1995 Plan; (ii) determining which persons may participate in the 1995 Plan and to which of such participants, if any, awards shall be granted under the 1995 Plan; (iii) granting awards to participants and determining the terms and conditions of awards granted under the 1995 Plan, including the number of shares of Common Stock issuable pursuant thereto; (iv) determining, with certain exceptions, the terms and conditions of the annual option grants to non-employee directors under the 1995 Plan; (v) determining whether, and the extent to which, anti-dilution adjustments are required and (vi) interpreting and construing the 1995 Plan and the terms and conditions of any awards granted under the 1995 Plan.

The anti-dilution provisions of the 1995 Plan generally provide for adjustments to the number of shares issuable pursuant to awards if the outstanding securities subject to the 1995 Plan increases or decreases as a result of certain events including, but not limited to, reorganization, merger, consolidation, recapitalization, restructuring, reclassification, dividend or other distribution. The anti-dilution provisions of the 1995 Plan also generally provide that no adjustment shall be made under the provisions of the 1995 Plan to the extent such adjustment would cause ISOs issued or issuable under the 1995 Plan to be treated as other than ISOs, or to the extent that the Committee determines that such adjustment would result in the disallowance of federal income tax deduction for compensation attributable to awards under the 1995 Plan by causing such compensation to be treated as other than performance-based compensation under Section 162(m) of the Internal Revenue Code.

The 1995 Plan currently does not specify a minimum exercise price or other consideration that a recipient of an award must pay to obtain the benefit of an award, and therefore the maximum compensation payable pursuant to the 1995 Plan, during the term of the 1995 Plan and awards granted thereunder, is currently equal to the number of shares of Common Stock with respect to which awards may be issued thereunder, multiplied by the value of such shares on the date such compensation is measured (which, in the case of non-statutory options, will generally be the date of exercise of the options). Awards may be issued under the 1995 Plan for any lawful consideration including services rendered by the recipient of such award. Any exercise price or other consideration payable in respect of any awards currently made under the 1995 Plan are to be determined by the Committee and included in the terms of such award. However, options automatically granted to non-employee directors on an annual basis will have an exercise price per share equal to the Fair Market Value of the Common Stock on the business day immediately preceding the date of the grant. Each such non-employee director option vests and becomes exercisable 25% at the end of each calendar quarter following the grant date, subject to the condition that the recipient is a director on such date.

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Awards may not be granted under the 1995 Plan on or after the twelfth anniversary of its adoption (ISOs may not be issued with a term over 10 years). Each Director Option granted under the 1995 Plan expires upon the first to occur of the following: (i) the first anniversary of the date upon which the optionee ceases to be a director as a result of death or total disability; (ii) the 90th day after the date upon which the optionee ceases to be a director for any reason other than death or total disability or (iii) the fifth anniversary of the date of grant of such Director Option.

An award may include a provision conditioning or accelerating the receipt of benefits upon the occurrence of specified events, such as a change in control of the Company (as defined by the Committee), an acquisition of a specified percentage of the voting power of the Company, the dissolution or liquidation of the Company, a sale of substantially all of the property and assets of the Company or other significant corporate transaction described in the 1995 Plan. Further, all outstanding Director Options theretofore granted under this 1995 Plan terminate upon the first to occur of the following: (i) the dissolution or liquidation of the Company; (ii) a reorganization, merger or consolidation of the Company as a result of which the outstanding securities of the class then subject to such outstanding Director Options are exchanged for or converted into cash, property and/or securities not issued by the Company, which reorganization, merger or consolidation shall have been affirmatively recommended to the stockholders of the Company by the Board or (iii) the sale of substantially all of the property and assets of the Company.

The tax treatment upon disposition of shares acquired under the 1995 Plan will depend on how long the shares have been held. In the case of shares acquired through exercise of a stock option, the tax treatment will also depend on whether or not the shares were acquired by exercising an incentive stock option. There will be no tax consequences to the Company upon the disposition of shares acquired under the 1995 Plan except that the Company may receive a deduction in the case of the disposition of shares acquired under an ISO before the applicable ISO holding period has been satisfied.

The 1995 Plan is not subject to any provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and is not required to be qualified under Section 401(a) of the Code.

New Plan Benefits

The cost to the Company of the change to be made to the 1995 Plan and the actual number of awards of stock, options or other equity compensation under the plan cannot be determined at this time. The following table discloses the number of shares subject to awards that have been granted under the 1995 Plan and that are outstanding as of September 30, 2006 to (i) the persons named under Executive Compensation Summary Compensation Table below, (ii) the Company's current executive officers as a group, (iii) the Company's current directors who are not executive officers as a group, and (iv) all employees as a group. The closing price of the Company's Common Stock on the Over the Counter Bulletin Board was \$1.73 on October 16, 2006.

Name of Individual or Identity of Group or Position	Number of Shares Subject To Options Granted (#)
Vincent J. Truant	420,833
D. Scott Houston	445,833
Paul Susie	