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# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM S-8

REGISTRATION STATEMENT  
UNDER  
THE SECURITIES ACT OF 1933

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### INHALE THERAPEUTIC SYSTEMS, INC.

(Exact name of Company as specified in its charter)

**Delaware**

(State of Incorporation)

**94-3134940**

(I.R.S. Employer Identification No.)

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**Inhale Therapeutic Systems, Inc.**

**150 Industrial Road  
San Carlos, CA 94070  
(650) 631-3100**

(Address of principal executive offices and zip code)

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**Shearwater Corporation 1996 Nonqualified Stock Option Plan, as amended**

(Full title of the plan)

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**Ajit S. Gill, Chief Executive Officer**

**Inhale Therapeutic Systems, Inc.**

**150 Industrial Road  
San Carlos, CA 94070  
(650) 631-3100**

(Name, address, and telephone number, including area code, of agent for service)

**Copies to:**

**Mark P. Tanoury, Esq.  
John M. Geschke, Esq.  
Cooley Godward LLP  
Five Palo Alto Square  
3000 El Camino Real  
Palo Alto, CA 94306-2155  
(650) 843-5000**

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### CALCULATION OF REGISTRATION FEE

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Title of Securities to be Registered	Amount to be Registered(1)	Proposed Maximum Offering Price per Share	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee
Shearwater Corporation 1996 Nonqualified Stock Option Plan, as amended	887,343	\$0.04	\$35,493.72	\$8.88

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- (1) Together with an indeterminate number of additional shares which may be necessary to adjust the number of shares reserved for issuance pursuant to such employee benefit plans as the result of any future stock split, stock dividend or similar adjustment of the Company's outstanding Common Stock.
- (2) Estimated solely for the purpose of calculating the amount of the registration fee pursuant to Rule 457(h) under the Securities Act of 1933, as amended (the "Securities Act") on the basis of the price at which the options may be exercised.
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### EXPLANATORY NOTE

The shares registered hereunder will be issued upon the exercise of stock options assumed by Inhale Therapeutic Systems, Inc., a Delaware corporation (the "Company" or the "registrant"), pursuant to the terms of the Agreement and Plan of Merger and Reorganization, dated May 22, 2001, as amended, by and between the Company, Shearwater Corporation ("Shearwater"), Square Acquisition Corp., a wholly owned subsidiary of the Company, J. Milton Harris and Puffinus, L.P. (the "Merger Agreement"). The transaction contemplated by the Merger Agreement was completed on June 29, 2001. These options were originally granted to employees and consultants of Shearwater under the Shearwater Corporation 1996 Nonqualified Stock Option Plan, as amended (the "Plan").

## INFORMATION REQUIRED IN THE SECTION 10(a) PROSPECTUS

The information required by Part I is included in documents sent or given to participants in the Plan pursuant to Rule 428(b)(1) of the Securities Act of 1933, as amended, (the "Securities Act").

### PART II

#### INFORMATION REQUIRED IN REGISTRATION STATEMENT

##### ITEM 3. INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The following documents filed by the Company with the Securities and Exchange Commission are incorporated by reference into this Registration Statement:

1. Our Annual Report on Form 10-K for the fiscal year ended December 31, 2000, filed on March 1, 2001, including all material incorporated by reference therein;
2. Our Amendment to Annual Report on Form 10-K/A for the fiscal year ended December 31, 2000, filed on May 1, 2001, including all material incorporated by reference therein;
3. Our Definitive Proxy on Schedule 14A, filed on May 1, 2001;
4. Our Quarterly Report on Form 10-Q for the quarter ended March 31, 2001, filed on May 14, 2001, including all material incorporated by reference therein;
5. Our Current Report on Form 8-K, filed on January 11, 2001;
6. Our Current Report on Form 8-K, filed on May 23, 2001;
7. Our Current Report on Form 8-K, filed on June 4, 2001;
8. Our Current Report on Form 8-K, filed on June 20, 2001;
9. Our Current Report on Form 8-K/A, filed on June 20, 2001;
10. Our Current Report on Form 8-K, filed on July 10, 2001;
11. Our Current Report on Form 8-K/A, filed on August 10, 2001;
12. All other reports filed by us pursuant to Section 13(a) or 15(d) of the Exchange Act since December 31, 2000, including all materials incorporated by reference therein; and
13. The description of the common stock contained in our Registration Statement on Form 8-A.

##### ITEM 4. DESCRIPTION OF SECURITIES

Not applicable.

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##### ITEM 5. INTERESTS OF NAMED EXPERTS AND COUNSEL

The validity of the issuance of the Common Stock offered hereby will be passed upon for the Company by Cooley Godward LLP, Palo Alto, California.

##### ITEM 6. INDEMNIFICATION OF DIRECTORS AND OFFICERS

Under Section 145 of the Delaware General Corporation Law, the Company has broad powers to indemnify our directors and officers against liabilities they may incur in such capacities, including liabilities under the Securities Act.

The Company's Certificate of Incorporation, as amended, provides for the elimination of liability for monetary damages for breach of the directors' fiduciary duty of care to the Company and its stockholders. These provisions do not eliminate the directors' duty of care and, in appropriate circumstances, equitable

remedies such as injunctive or other forms of non-monetary relief will remain available under Delaware law. In addition, each director will continue to be subject to liability for breach of the director's duty of loyalty to the Company, for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, for any transaction from which the director derived an improper personal benefit and for violating Section 174 of the Delaware General Corporation Law. The provisions in the Certificate do not affect a director's responsibilities under any other laws, such as the federal securities laws or state or federal environmental laws.

The Company has entered into agreements with its directors and executive officers that require the Company to indemnify such persons against expenses, judgments, fines, settlements and other amounts actually and reasonably incurred (including expenses of a derivative action) in connection with any proceeding, whether actual or threatened, to which any such person may be made a party by reason of the fact that such person is or was a director or officer of the Company or any of its affiliated enterprises, provided such person acted in good faith and in a manner such person reasonably believed to be in or not opposed to the best interests of the Company and, with respect to any criminal proceeding, had no reasonable cause to believe his or her conduct was unlawful. The indemnification agreements also set forth certain procedures that will apply in the event of a claim for indemnification thereunder.

#### ITEM 7. EXEMPTION FROM REGISTRATION CLAIMED

Not applicable.

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#### ITEM 8. EXHIBITS

4.1	(1)	Certificate of Incorporation of Inhale.
4.2	(1)	Bylaws of Inhale.
4.3	(8)	Certificate of Amendment of the Amended Certificate of Incorporation.
4.4	(2)	Restated Investor Rights Agreement among Inhale and certain other persons named therein, dated April 29, 1993, as amended October 29, 1993.
4.5	(3)	Stock Purchase Agreement between Inhale and Pfizer Inc., dated January 18, 1995.
4.6	(4)	Form of Purchase Agreement between Inhale and the individual Purchasers, dated January 28, 1997.
4.7	(5)	Stock Purchase Agreement between Inhale and Capital Research and Management Company, dated December 8, 1998.
4.8	(6)	Purchase Agreement among Inhale and Lehman Brothers Inc., Deutsche Bank Securities Inc. and U.S. Bancorp Piper Jaffray Inc. dated October 6, 1999.
4.9	(6)	Registration Rights Agreement among Inhale and Lehman Brothers Inc., Deutsche Bank Securities Inc. and U.S. Bancorp Piper Jaffray Inc., dated October 13, 1999.
4.10	(6)	Indenture between Inhale as Issuer and Chase Manhattan Bank and Trust Company, National Association, as Trustee, dated October 13, 1999.
4.11	(6)	Form of Inhale Registration Rights Agreement, between Inhale and Selling Shareholder, dated January 25, 2000.
4.12	(7)	Purchase Agreement among Inhale and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities Inc., Lehman Brothers Inc., and U.S. Bancorp Piper Jaffray Inc., dated February 2, 2000.
4.13	(7)	Resale Registration Rights Agreement among Registrant and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities Inc., Lehman Brothers Inc., and U.S. Bancorp Piper Jaffray Inc., dated February 8, 2000.
4.14	(7)	Indenture between Registrant as Issuer and Chase Manhattan Bank and Trust Company, National Association, as Trustee, dated February 8, 2000.
4.15	(8)	Specimen common stock certificate.
4.16	(9)	Specimen warrants to purchase shares of common stock.
4.17	(10)	Purchase Agreement among Inhale and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities Inc., Lehman Brothers Inc., and U.S. Bancorp Piper Jaffray Inc., dated October 11, 2000.
4.18	(10)	Resale Registration Rights Agreement among Registrant and Merrill Lynch, Pierce, Fenner & Smith Incorporated, Deutsche Bank Securities, Inc., Lehman Brothers Inc., and U.S. Bancorp Piper Jaffray Inc., dated October 17, 2000.
4.19	(10)	Indenture between Registrant, as Issuer, and Chase Manhattan Bank and Trust Company, National Association, as Trustee, dated October 17, 2000.
4.20	(11)	Certificate of Designation of Series A Junior Participating Preferred Stock.
4.21	(11)	Rights Agreement dated as of June 1, 2001 among Inhale Therapeutic Systems, Inc. and Mellon Investor Services LLC.
4.22	(11)	Form of Right Certificate.
5.1	(12)	Opinion of Cooley Godward LLP.
23.1	(12)	Consent of Ernst & Young LLP, independent auditors.
23.2	(12)	Consent of Ernst & Young LLP, independent auditors.
23.3	(12)	Consent of Cooley Godward LLP (included in Exhibit 5.1)
24.1	(12)	Power of Attorney (included in signature page).
99.1	(12)	Shearwater Corporation 1996 Nonqualified Stock Option Plan
99.2	(12)	Amendment to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation, effective May 22, 1998

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99.3	(12)	Second Amendment to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation, effective February 26, 2000
99.4	(12)	Third Amendment to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation, effective October 5, 2000
99.5	(12)	Fourth Amendment to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation, effective June 22, 2001
99.6	(12)	Form of Shearwater Corporation Nonqualified Stock Option Agreement
99.7	(12)	Form of June 2001 Amendment to Shearwater Corporation Nonqualified Stock Option Agreements

(1) Incorporated by reference to the indicated exhibit in Inhale's Quarterly Report on Form 10-Q for the quarter ended June 30, 1998.

(2)

Incorporated by reference to the indicated exhibit in Inhale's Registration Statement on Form S-1 (No. 33-75942), as amended.

- (3) Incorporated by reference to the indicated exhibit in Inhale's Registration Statement on Form S-1 (No. 33-89502), as amended.
- (4) Incorporated by reference to Inhale's Registration Statement on Form S-3 (No. 333-20787).
- (5) Incorporated by reference to the indicated exhibit in Inhale's Registration Statement on Form S-3 (No. 333-68897), as amended.
- (6) Incorporated by reference to the indicated exhibit in Inhale's Registration Statement on Form S-3 (No. 333-94161), as amended.
- (7) Incorporated by reference to the indicated exhibit in Inhale's Annual Report on Form 10-K for the year ended December 31, 1999.
- (8) Incorporated by reference to the indicated exhibit in Inhale's Quarterly Report on Form 10-Q for the quarter ended June 30, 2000.
- (9) Incorporated by reference to the indicated exhibit in Inhale's Quarterly Report on Form 10-Q for the quarter ended September 30, 2000.
- (10) Incorporated by reference to Inhale's Registration Statement on Form S-3 (No. 333-53678), filed on January 12, 2001.
- (11) Incorporated by reference to the indicated exhibit in Inhale's Current Report on Form 8-K, filed on June 4, 2001.
- (12) Filed herewith.

#### ITEM 9. UNDERTAKINGS

1. The undersigned registrant hereby undertakes:

(a) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

(i) To include any prospectus required by section 10(a)(3) of the Securities Act of 1933;

(ii) To reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed

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that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement.

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement;

*Provided, however,* that paragraphs (a)(i) and (a)(ii) of this section do not apply if the information required to be included in a post-effective amendment by those paragraphs is contained in periodic reports filed with or furnished to the Commission by the registrant pursuant to section 13 or section 15(d) of the Securities Exchange Act of 1934 that are incorporated by reference herein.

(b) That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered herein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

(c) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

2. The undersigned registrant hereby undertakes that, for purposes of determining any liability under the Securities Act of 1933, each filing of the registrant's annual report pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 (and, where applicable, each filing of an employee benefit plan's annual report pursuant to section 15(d) of the Securities Exchange Act of 1934) that is incorporated by reference in the registration statement shall be deemed to be a new registration statement relating to the securities offered herein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

3. Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification against such

liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

**SIGNATURES**

Pursuant to the requirements of the Securities Act of 1933, the registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form S-8 and has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Carlos, State of California, on August 10, 2001.

**INHALE THERAPEUTIC SYSTEMS, INC.**  
a Delaware corporation

By: /s/ AJIT S. GILL

Ajit S. Gill

Title: Chief Executive Officer and President

**POWER OF ATTORNEY**

KNOW ALL PERSON BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Ajit S. Gill and Brigid A. Makes and each of them, as his or her true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments (including post-effective amendments, exhibits thereto and other documents in connection therewith) to this registration statement and any subsequent registration statement filed by the registrant pursuant to Securities and Exchange Commission Rule 462, which relates to this registration statement and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratify and confirming all that said attorneys-in-fact and agents, or any of them, or their or his or her substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, registration statement has been signed by the following persons in the capacities and on the dates indicated:

SIGNATURE	TITLE	DATE
/s/ AJIT S. GILL	Chief Executive Officer and President	August 10, 2001
Ajit S. Gill		
/s/ ROBERT B. CHESS	Chairman of the Board	August 10, 2001
Robert B. Chess		
/s/ BRIGID A. MAKES	Chief Financial Officer and Vice President (Principal Financial and Accounting Officer)	August 10, 2001
Brigid A. Makes		
/s/ JOHN S. PATTON	Vice President and Director	August 10, 2001
John S. Patton		

/s/ JAMES B. GLAVIN	Director	August 10, 2001
James B. Glavin		
/s/ MELVIN PERELMAN	Director	August 10, 2001
Melvin Perelman		
Irwin Lerner	Director	
/s/ ROY A. WHITFIELD	Director	August 10, 2001

## EXHIBIT INDEX

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[SIGNATURES](#)

[POWER OF ATTORNEY](#)

[EXHIBIT INDEX](#)

**OPINION OF COOLEY GODWARD LLP**

August 10, 2001

Inhale Therapeutic Systems, Inc.  
150 Industrial Road  
San Carlos, CA 94070

Ladies and Gentlemen:

You have requested our opinion with respect to certain matters in connection with the filing by Inhale Therapeutic Systems, Inc., a Delaware corporation (the "Company"), of a Registration Statement on Form S-8 (the "Registration Statement") with the Securities and Exchange Commission (the "Commission") covering up to 887,343 shares of the Company's Common Stock, \$.0001 par value (the "Shares"), for issuance pursuant to the Company's assumption of such options issued under the Shearwater Corporation 1996 Nonqualified Stock Option Plan, as amended, (the "Plan") and assumed pursuant to the terms of the Agreement and Plan of Merger and Reorganization dated May 22, 2001, as amended, by and among the Company, Shearwater Corporation ("Shearwater"), Square Acquisition Corp., a wholly owned subsidiary of the Company, J. Milton Harris and Puffinus, L.P.

In connection with this opinion, we have examined and relied upon the Registration Statement and related Prospectus, the Company's Certificate of Incorporation, as amended, and Bylaws, as currently in effect, and the originals or copies certified to our satisfaction of such records, documents, certificates, memoranda and other instruments as in our judgment are necessary or appropriate to enable us to render the opinion expressed below. We have assumed the genuineness and authenticity of all documents submitted to us as originals, the conformity to originals of all documents submitted to us as copies thereof and the due execution and delivery of all documents where due execution and delivery are a prerequisite to the effectiveness thereof.

On the basis of the foregoing, and in reliance thereon, we are of the opinion that the Shares, when sold and issued in accordance with the Registration Statement, the Plan and the options granted thereunder will be validly issued, fully paid and non-assessable.

We consent to the filing of this opinion as an exhibit to the Registration Statement.

Very truly yours,

COOLEY GODWARD LLP

/s/ NANCY H. WOJTAS

\_\_\_\_\_  
Nancy H. Wojtas, Esq.

QuickLinks

[EXHIBIT 5.1](#)

[OPINION OF COOLEY GODWARD LLP](#)



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**Exhibit 23.1**

### **Consent of Independent Auditors**

We consent to the incorporation by reference in the Registration Statement (Form S-8) of Inhale Therapeutic Systems, Inc. of our report dated February 7, 2001, with respect to the financial statements of Shearwater Polymers, Inc. for the year ended June 30, 2000 included in the Inhale Therapeutic Systems, Inc. Current Report Form 8-K Amendment No. 1, dated August 10, 2001, filed with the Securities and Exchange Commission.

/s/ ERNST & YOUNG LLP

Birmingham, Alabama  
August 8, 2001

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QuickLinks

[Exhibit 23.1](#)

[Consent of Independent Auditors](#)

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**Exhibit 23.2**

**Consent of Ernst & Young LLP, Independent Auditors**

We consent to the incorporation by reference in the Registration Statement (Form S-8) of Inhale Therapeutic Systems, Inc., pertaining to the Shearwater Corporation 1996 Nonqualified Stock Option Plan, as amended, of our report dated January 23, 2001, with respect to the consolidated financial statements of Inhale Therapeutic Systems, Inc. included in its Annual Report, as amended (Form 10-K/A), for the year ended December 31, 2000, filed with the Securities and Exchange Commission, and of our report dated January 5, 2001, with respect to the financial statements of Bradford Particle Design plc included in the Current Report (Form 8-K) of Inhale Therapeutic Systems, Inc., filed with the Securities and Exchange Commission.

/s/ ERNST & YOUNG LLP

Palo Alto, California  
August 9, 2001

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QuickLinks

[Exhibit 23.2](#)

[Consent of Ernst & Young LLP, Independent Auditors](#)

**SHEARWATER POLYMERS, INC.**

**1996 NONQUALIFIED STOCK OPTION PLAN**

**ARTICLE I  
DEFINITIONS**

**Section 1.1 Definitions**

As used herein, the following terms shall have the meanings hereinafter set forth unless the context clearly indicates to the contrary:

- (a) "Board" shall mean the Board of Directors of the Company.
- (b) "Code" means the Internal Revenue Code of 1986, as may be amended from time to time, and any successive laws thereto.
- (c) "Company" shall mean Shearwater Polymers, Inc., an Alabama corporation, and any successor in interest thereto.
- (d) "Fair Market Value" shall mean, if applicable, the closing price per share of the Stock on the principal United States securities exchange registered under the 1934 Act on which such Stock is sold in the regular way; or the last sales price per share of the Stock quoted on an automated quotation system of a registered securities association on which such Stock is sold in a regular way; or if the Stock is not registered or traded in such a manner that such quotations are available, the Fair Market Value shall be deemed to be the fair value per share of Stock, taking into consideration all normal discounts, determined in good faith by the Board as of a date which is within 365 days of the date in which the determination is to be made.
- (e) "Internal Revenue Code" shall mean the Internal Revenue Code of 1986, as amended, and any regulations promulgated thereunder.
- (f) "Key employees" means those employees, including officers and directors (including any nonemployee director), of the Company or its subsidiaries who, in the judgment of the Board, directly or through the Committee, are considered (i) to be unusually valuable, (ii) to possess superior training, experience or ability, and/or (iii) to be actively interested in the development and financial success of the Company.
- (g) "1934 Act" shall mean the Securities Exchange Act of 1934, as amended from time to time.
- (h) "Nonqualified stock option" means an Option to purchase Stock which at the time such Option is granted does not qualify as an Incentive Stock Option within the meaning of § 422 of the Code.
- (i) "Option" shall mean an Option to purchase Stock granted pursuant to the provisions of Article VI hereof.
- (j) "Participant" shall mean a key employee of the Company or any of its subsidiaries to whom an Option has been granted hereunder.
- (k) "Plan" shall mean the Shearwater Polymers, Inc. 1996 Nonqualified Stock Option Plan, the terms of which are set forth herein.
- (l) "Stock," with respect to each share to which that term refers, shall mean one (1) share of Common Stock, par value \$0.01, of the Company now authorized; any other shares of such Stock

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of the Company hereafter authorized; and securities of the Company which, under any conditions, will be converted into or exchanged for any such Stock.

(m) "Stock Option Agreement" shall mean the agreement between the Company and the Participant under which the Participant may purchase Stock hereunder.

**ARTICLE II  
THE PLAN**

**Section 2.1 Name**

This Plan shall be known as the "Shearwater Polymers, Inc. 1996 Nonqualified Stock Option Plan."

**Section 2.2 Purpose**

The purpose of the Plan is to provide a means whereby the Company may, through nonqualified stock options:

- (a) Attract to the Company and to its subsidiaries and affiliates, new employees whose services are considered unusually valuable;
- (b) Retain in the employ of the Company persons with superior training, experience, and ability; and
- (c) Encourage in all employees a sense of proprietorship and an active interest in the development and financial success of the Company.

**Section 2.3 Effective Date**

The Plan was adopted by the Board of Directors and approved by the shareholders of the Company on December 12, 1996 and became effective as of December 12, 1996. The Plan and all Options granted hereunder are subject to the receipt by the Company of any consents or approvals required to adopt the Plan and/or grant Options under applicable law and under any permit, agreement or instrument to which the Company is a party or by which any of its properties or assets are bound. Any Option granted prior to any such consent and approval of the Plan as herein provided shall be subject to such consent or approval and shall have no legal effect and shall convey no rights to the holder thereof in the event such consent or approval of the Plan is not obtained. No Options may be granted under this Plan later than ten (10) years from the effective date of the Plan. Although no Options may be granted hereunder after ten (10) years from the effective date of the Plan, all terms, conditions and restrictions of the Plan shall remain in full force and effect after such time.

### **ARTICLE III PARTICIPANTS**

Except as otherwise provided herein, any key employee of the Company or its subsidiaries, shall be eligible to participate in the Plan. Subject to the express provisions of the Plan, the Board may grant Options to any eligible key employee of the Company or its subsidiaries in accordance with such determinations as the Board from time to time in its sole discretion shall make.

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### **ARTICLE IV ADMINISTRATION**

#### **Section 4.1 Duties and Powers of Board**

The Plan shall be administered by the Board. The Board shall have the following powers in the administration of the Plan:

(a) All decisions, determinations and actions of the Board made or taken pursuant to grants of authority under the Plan shall be made or taken according to the sole discretion of the Board and shall be final, conclusive and binding upon all persons for all purposes.

(b) The Board shall have full power, discretion and authority to interpret, construe and administer the Plan and any part thereof, and its interpretations and constructions thereof and actions taken thereunder shall be, except as otherwise determined by the Board, final, conclusive and binding on all persons for all purposes.

(c) The Board's decisions under the Plan need not be uniform and may be made selectively among employees, whether or not such employees are similarly situated. In addition, subject to the Plan's express provisions, the Board may grant the Options subject to any terms and conditions it establishes, and the Options granted may be granted to different persons, or to the same person at different times and may be subject to terms, conditions and restrictions which differ from each other.

(d) The Board shall keep minutes of its actions taken under the Plan. The act of a majority of the members of the Board present at a meeting duly called and held shall be the act of the Board. Any decisions or determination reduced to writing and signed by all members of the Board shall be fully as effective as if made by unanimous vote at a meeting duly called and held.

(e) The Board may employ such legal counsel, including without limitation independent legal counsel and counsel regularly employed by the Company, and accountants, consultants and agents as the Board may deem appropriate for the administration of the Plan, and may rely upon any opinions received from any such counsel, accountant, consultant or agent and any computations received from any such counsel, accountant, consultant or agent. All expenses incurred by the Board in interpreting and administering the Plan, including without limitation, meeting fees and expenses and professional fees, shall be paid by the Company.

(f) No member or former member of the Board shall be liable for any action or determination made in good faith with respect to the Plan or any Option granted under the Plan. Each member or former member of the Board shall be indemnified and held harmless by the Company against all cost or expense (including counsel fees) or liability (including any sum paid in settlement of a claim with the approval of the Board) arising out of any act or omission to act in connection with the Plan unless arising out of such member's or former member's own fraud or bad faith. Such indemnification shall be in addition to any rights of indemnification the members or former members may have as directors under the bylaws of the Company.

#### **Section 4.2 Company Assistance**

The Company shall supply full and timely information to the Board on all matters relating to eligible key employees, their employment, death, retirement, disability, or other termination of employment, and such other pertinent facts as the Board may require. The Company shall furnish the Board with such clerical and other assistance as is necessary in the performance of its duties.

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### **ARTICLE V SHARES OF STOCK SUBJECT TO PLAN**

#### **Section 5.1 Limitations**

The number of shares of Stock which may be issued and sold hereunder shall not exceed 250,000 shares of Stock, subject to adjustment pursuant to the provisions of Section 5.3 hereof. Such shares may be either authorized and unissued shares or shares issued and thereafter acquired by the Company, and such amount of shares shall be and is hereby reserved for issuance pursuant to this Plan. Any of such shares which may remain unsold and which are not subject to outstanding Options at the termination of the Plan shall cease to be reserved for the purpose of the Plan, but until the termination of the Plan, the Company shall at all times reserve a sufficient number of shares of Stock to meet the requirements of the Plan.

## **Section 5.2 Options Granted Under Plan**

Shares of Stock with respect to which an Option granted hereunder shall have been exercised shall not again be available for grant hereunder. If Options granted hereunder shall expire, terminate, or be canceled for any reason without being wholly exercised, new Options may be granted hereunder covering the number of shares of Stock to which such Option expiration, termination, or cancellation relates.

## **Section 5.3 Antidilution**

In the event that the Stock is hereafter increased, decreased, or changed into or exchanged for a different number or kind of shares or other securities of the Company by reason of merger, consolidation, reorganization, recapitalization, reclassification, combination of shares, stock split, or stock dividend after the effective date of the Plan:

(a) the aggregate number and kind of shares of Stock subject to Options which may be granted hereunder shall be adjusted appropriately; and

(b) rights under outstanding Options granted hereunder, both as to the number of subject shares of Stock and the Option price, shall be adjusted appropriately.

In the event of a dissolution or liquidation of the Company, the Options granted hereunder shall terminate; provided, however, that the Participants shall have the right for a period of thirty (30) days prior to such dissolution or liquidation to exercise outstanding Options in full without regard to any installment exercise provisions and whether the Option by its terms is at such time immediately exercisable in full, to the extent it shall not have been exercised. In the event of (i) any merger, consolidation, or combination involving the Company, other than (A) any merger, consolidation, or combination that is solely for the purpose of changing the domicile of the Company, and (B) any merger, consolidation, or combination that would result in the holders of the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by the securities remaining outstanding or by being converted into voting securities of the surviving entity) more than fifty percent (50%) of the combined voting power of the voting securities of the Company (or such surviving entity) outstanding immediately after such merger, consolidation, or combination, or (ii) any sale of substantially all the assets of the Company or a sufficient amount of Stock in the Company (whether by tender offer, original issuance, or a single or series of related Stock purchase and sale agreements and/or transactions) sufficient to confer on the purchaser or purchasers thereof (whether individually or in a group) the ability to elect a majority of the Board of Directors of the Company, the Participants shall have the right, immediately prior to such merger, consolidation, combination, or asset or Stock sale to exercise outstanding Options in full, without regard to any installment exercise provisions and whether the Option by its terms is at such time immediately exercisable in full, to the

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extent that it shall not have been exercised. In the event of a transaction of the nature described in (i) above (including, without limitation, in (i)(A) and (i)(B) above), nothing contained herein shall prevent the Board and the board of directors of the surviving corporation and/or the acquiring corporation from converting an Option into an Option to purchase Stock in the surviving or acquiring corporation on a fair and equitable basis. In the event of a transaction described in (i) (including, without limitation, in (i)(A) and (i)(B)) and (ii) above, the Board shall be entitled in its discretion to require Participants either to exercise their Options prior to such transactions becoming effective or to forfeit them in the absence of such an exercise.

The foregoing adjustments and the manner of application of the foregoing provisions shall be determined solely by the Board, and any such adjustment shall provide for the elimination of fractional share interests.

## **ARTICLE VI OPTIONS**

### **Section 6.1 Option Grant and Agreement**

Each Option granted hereunder shall be evidenced by a Stock Option Agreement dated as of the date of grant and executed by the Company and the Participant, which Agreement shall set forth such terms and conditions as may be determined by the Board consistent with the Plan.

### **Section 6.2 Option Price**

The per share price of the Stock subject to each Option shall be determined by the Board in the exercise of its discretion, with due consideration for the compensation and incentive purposes of this Plan, but said per share price shall not be less than the par value of the Stock on the date the Option is granted or any time during which the Option is exercisable.

### **Section 6.3 Option Period**

Each Option granted hereunder must be granted within ten (10) years from the effective date of the Plan. The period for the exercise of each Option shall be determined by the Board, but in no instance shall such period exceed ten (10) years from the effective date of the grant of the Option.

### **Section 6.4 Option Exercise**

(a) Options may be exercised with respect to whole shares only, for such shares of Stock and within the period permitted by the exercise thereof as determined by the Board, and shall be exercised by written notice of intent to exercise the Option with respect to a specified number of shares of Stock delivered to the Company at its principal office in the State of Alabama, and payment in full to the Company at said office of the amount of the Option price for the number of shares of Stock with respect to which the Option is then being exercised.

(b) The Option price upon exercise of any Option shall be payable to the Company in full in cash or its equivalent.

(c) No Option granted hereunder shall be exercisable unless at all times during the period beginning on the date of the granting of such Option and ending on the day which is the date of exercise (or ending on the day which is twelve (12) months before the date of exercise in the event of the total and permanent disability or death of a Participant) the Participant was a director, officer, or full-time employee of either the Company or a subsidiary of the Company, or a corporation (or parent or subsidiary of such corporation) issuing or assuming such Option in accordance with the terms of this Plan.

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### Section 6.5 Nontransferability of Option

No Option shall be transferred by a Participant otherwise than by will or the laws of descent and distribution. During the lifetime of a Participant, the Option shall be exercisable only by the Participant.

### Section 6.6 Effect of Termination of Employment or Directorship

(a) If the employment or directorship of a Participant to whom an Option shall have been granted is terminated for any reason, other than death or total disability, such Option shall terminate immediately upon such termination.

(b) If a Participant to whom an Option shall have been granted shall die or become totally and permanently disabled (as defined in the first sentence of Section 72(m)(7) of the Code, or as determined by the Board in its discretion), while such Participant is employed by or serving as a director, officer or full-time employee of the Company or its subsidiaries, such Option shall terminate immediately upon such termination; however, to the extent the Participant would otherwise have been entitled to exercise at the date of such Participant's death or termination due to total and permanent disability, such Participant, such Participant's personal representatives, the executor or administrator of the estate of the Participant, or the person or persons to whom an Option granted hereunder shall have been validly transferred pursuant to a will or the laws of descent and distribution, at any time prior to the expiration date of the Option or within twelve (12) months after the date of such death or disability, whichever shall first occur, shall have the right to exercise such Option in full, without regard to any installment exercise provisions and while the Option by its terms is at such time immediately exercisable in full, to the extent that such Option shall not have been previously exercised. Any Stock received as a result of such exercise shall be subject to the terms of Article VII hereof.

(c) No transfer of an Option by the Participant by will or by the laws of descent and distribution shall be effective to bind the Company unless the Company shall have been furnished with written notice thereof and an authenticated copy of the will and/or such other evidence as the Board may deem necessary to establish the validity of the transfer and the acceptance by the transferee or transferees of the terms and conditions of such Option.

(d) The Board may, in its sole discretion, either at the date of the execution of a Stock Option Agreement or at any time thereafter, increase the amount of time during which a Participant or a Participant's personal representative, executor, administrator, or other legatee or devisee may exercise such Option following such Participant's termination, as set forth in Section 6.6 (b) above.

### Section 6.7 Rights as Shareholder

A Participant or a transferee of an Option shall have no rights as a shareholder with respect to any shares subject to such Option prior to the purchase and issuance of such shares by exercise of such Option as provided herein.

### Section 6.8 Dividends

No adjustment shall be made for dividends (ordinary or extraordinary, whether in cash, securities or other property) or distributions or other rights for which the record date is prior to the date such Option is authorized and a Stock Certificate for said Stock is issued, except as provided in Section 5.3 hereof.

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### Section 6.9 Repurchase of Options

The Company shall have the right from time to time to purchase any outstanding Option or Options or any portion thereof, in the Company's sole and absolute discretion, at an amount equal to the amount by which the Fair Market Value of the shares of Stock represented by such Option or Options or any portion thereof exceeds the exercise price of such Option or Options, as the Company so elects to purchase. Upon the purchase of any Option, Options or any portion thereof, the Option, Options or any portion thereof shall immediately be cancelled and terminated and, in accordance with Section 5.2 hereof, the Company shall have the right to issue additional Options regarding the shares of Stock to which the original Option or Options or portions thereof related.

## ARTICLE VII STOCK REDEMPTIONS/RESTRICTIONS

### Section 7.1 General Redemption

In addition to the restrictions set forth in Sections 7.2 and 7.3 hereof, the Company may require the Participants in this Plan to agree, in the Stock Option Agreements or other agreements executed incident to this Plan, to have the Stock issued to them under this Plan redeemed by the Company in the event the employment or directorship of the Participant is terminated (including, without limitation, termination because of death or permanent disability or voluntary or involuntary termination of employment).

### Section 7.2 Restrictions

By purchasing the Stock under this Plan being offered to any Participant, a Participant shall agree and consent to the following:

(a) *Restrictions.* No shares of Stock purchased pursuant to or in connection with this Plan or an Option granted hereunder will be conveyed, transferred, encumbered or otherwise disposed of (any such disposition being herein called a "transfer") by the Participant holding such shares of Stock, unless all shares of Stock covered by this Plan owned by such Participant first have been offered to the Company at a price per share equal to the original price paid by the Participant for all such shares of Stock. The Company will have 30 days from the date it receives any such offer to accept, by notice given to the Participant. If the Company does accept, the purchase and sale of such shares of Stock will occur at the Company's principal office in the State of Alabama at the time and date specified in such notice of acceptance. In no event, however, will the date for consummating the transaction be later than 60 days from the date of the notice of acceptance. At the closing, the Participant will deliver to the Company certificates representing all of the shares

of Stock subject to the offer, duly endorsed, with all necessary transfer stamps affixed. Upon receipt of such share certificates, the Company will deliver to the Participant a check in the amount of the purchase price.

(b) *Requirements of Transfer.* No shares of Stock subject to the restrictions under the Plan will be transferred on the Company's books until the Company has received in writing from the transferee an agreement to be bound by the provisions and restrictions of this Plan, as well as any other agreements restricting or otherwise affecting the transfer and ownership of shares of Stock of the Company.

(c) Any transfer or purported transfer, including without limitation, any transfer by will or by laws of descent and distribution made by a purchaser of shares of Stock under this Plan, except at the times and in the manner herein specified and until receipt by the Company of such agreement, referenced in (b) above, will be null and void and the Company shall not recognize or give effect

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to such transfer on its books and records or recognize the person or persons to whom such proposed transfer has been made as the legal or beneficial Participant of those shares of Stock.

(d) If the Company fails to accept the offer within the 30-day period of paragraph 7.2(a) above, then the Participant holding such shares of Stock will have the right for a period of 45 days, subject to compliance with all of the other terms of this Plan, to dispose of such shares of Stock at not less than the Fair Market Value of such Stock, provided that any transferee will take such shares of Stock subject to the same restrictions, including the Company's continuing right of first refusal and its right to repurchase the shares of Stock upon the occurrence of an Event of Resale as set forth in paragraph 7.2(g) hereof, and its right of repurchase set forth in Section 7.3 hereof.

(e) Notwithstanding anything in this Plan to the contrary, upon the death of a Participant holding shares of Stock subject to this Plan, those shares of Stock may be conveyed by will or by the laws of descent and distribution, subject to the provisions of the Plan and to applicable provisions of any other Agreement by which the Company may be bound, without first being offered to the Company. Any successor in interest to the Participant in such event may not further convey, transfer, encumber or otherwise dispose of such shares of Stock except as provided herein.

(f) Certificates representing shares of Stock which are subject to this Plan will bear the following legend, or a legend in substantially the same form, in addition to such other legends as counsel to the Company may deem appropriate:

#### RESTRICTED SHARES

These securities have not been registered under the Securities Act of 1933 or the securities or blue sky laws of any state, and they may not be sold, offered for sale, transferred, assigned, pledged or otherwise disposed of in the absence of an opinion of counsel (which counsel and opinion shall be satisfactory to counsel for the Company) that such sale, offer for sale, transfer, assignment, pledge or other disposition does not violate the requirements of such Act and any applicable state securities laws, or any other applicable laws and regulations.

The right to transfer, sell, exchange, give, pledge, encumber or otherwise dispose of the shares of stock represented by this certificate is restricted in accordance with that certain Shearwater Polymers, Inc. Nonqualified 1996 Stock Option Plan and that certain Stock Option Agreement dated \_\_\_\_\_, \_\_\_\_\_, all as the same may be amended from time to time. Copies of the Plan and the Agreement are available for inspection at the offices of the Company.

The shares of Stock represented by this certificate are subject to the Shearwater Polymers, Inc.'s continuing, right of first refusal and other rights to purchase and to all other terms, conditions, and restrictions of the Company's 1996 Nonqualified Stock Option Plan, a copy of which is on file and available for inspection during normal business hours at the Company's principal office.

The sale or transfer of this security is subject to certain restrictions set forth in the articles of incorporation and/or written agreements, copies of which may be obtained from the secretary of the corporation.

(g) *Events of Resale.*

(i) *Termination of Employment Other Than Death or Disability.* If any of the events listed in this paragraph (g)(i) (the events listed in paragraphs g(i) and g(ii) are herein referred to as "Events of Resale") occurs or, having occurred, continues in effect, the Participant shall sell to the Company and the Company shall have the option to purchase from the Participant

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all the shares of Stock purchased by the Participant under this Plan. The purchase price per share of Stock in such case will equal the original price paid by the Participant for such shares of Stock:

1. if the employment or directorship of the Participant by the Company or its subsidiaries is terminated other than by reason of the Participant's death or permanent and total disability (as defined in the first section of Section 72(m) of the Code); or
2. if the Participant, having been nominated as a director of the Company, fails or refuses to stand for election or, if elected, to serve as such or resigns as a director; or
3. if the Participant receives shares of Stock subject to any other Event of Resale imposed by the Board in the Stock Option Agreement, and such Event of Resale occurs.

(ii) *Termination of Employment by Death or Disability.* If the employment of the Participant by the Company or its subsidiaries is terminated by reason of the Participant's death or permanent and total disability (as defined in the first section of Section 72(m) of the Code), the Participant

or the Participant's personal representative, heirs, executors or administrators shall sell to the Company and the Company shall have the option to purchase from the Participant or the Participant's personal representative, heirs, executors or administrators all of the shares of Stock purchased by the Participant under this Plan. The purchase price per share of Stock in such case shall equal the Fair Market Value of the Stock.

(iii) *Closing.* Within 30 days after the Company's receipt of notice of an occurrence of an Event of Resale, the Company, by notice to the Participant, will state that an Event of Resale has occurred, notify the Participant of the Company's intent to exercise or not exercise its option to repurchase the Stock and if the Company agrees to exercise its option to repurchase such Stock, the Company will specify a date not less than five, and not more than ten days, from the date of such notice to consummate the purchase and sale of such shares of Stock at the Company's principal office. In the event the Company does not exercise its option to repurchase the Stock, the Stock shall nevertheless be subject to the terms of the Plan. At the closing, the Participant will deliver to the Company certificates representing all of the shares of Stock purchased hereunder, and duly endorsed with all necessary transfer stamps affixed. Upon the receipt of such share certificates, the Company will deliver to the Participant a check in the amount of the purchase price. If the Participant fails to deliver the share certificates to the corporation at the closing, the Company may deposit the purchase price with the Secretary or Treasurer of the Company, and thereafter the shares of Stock will be deemed to have been transferred to the Company and the Participant, despite the Participant's failure to deliver the share certificates, will have no further rights derived from such shares of Stock as a shareholder of the Company. In this event, the Secretary or the Treasurer of the Company will continue to hold the purchase price for such shares of Stock and will make payment thereof, without interest, upon delivery of the share certificates to the Company, accompanied by the appropriate endorsements.

### **Section 7.3 Stock Purchase by Company**

The Company shall have the right from time to time to purchase any outstanding Stock acquired by any Participant pursuant to any Option or Options or any portion thereof, in the Company's sole and absolute discretion, at an amount equal to the Fair Market Value of the Stock the Company so elects to purchase. Upon the purchase of any shares of Stock, the Company shall have the right to issue additional Options regarding the shares of Stock so purchased by the Company.

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## **ARTICLE VIII STOCK CERTIFICATES**

The Company shall not be required to issue or deliver any certificate for shares of Stock purchased upon the exercise of an Option granted hereunder or any portion thereof, prior to fulfillment of all of the following conditions:

- (a) the completion of any registration or other qualification of such shares of Stock under any federal or state law or under the rulings or regulations of the Securities and Exchange Commission or any other governmental regulatory body, which the Board shall in its sole discretion deem necessary or advisable;
- (b) the obtaining of any approval or other clearance from any federal or state governmental agency which the Board shall in its sole discretion determine to be necessary or advisable;
- (c) the lapse of such reasonable period of time following the exercise of the Option as the Board from time to time may establish for reasons of administrative convenience;
- (d) the compliance with any and all applicable federal, state or local laws;
- (e) the execution by the Participant of a shareholder buy-sell agreement among the Company and the shareholders thereof; and
- (f) such other terms and conditions as may be set forth in the Stock Option Agreement.

In addition to the legends required pursuant to Section 7.2(f), the Company shall further be entitled to place whatever legends on such certificate as it shall deem reasonably necessary or appropriate.

## **ARTICLE IX TERMINATION, AMENDMENT, AND MODIFICATION OF THE PLAN**

### **Section 9.1 Generally**

The Board may at any time terminate, and may at any time and from time to time and in any respect amend, modify or suspend the Plan; provided, however, that no such action of the Board without approval of the shareholders of the Company may:

- (a) increase the total number of shares of Stock subject to the Plan except as contemplated in Section 5.3 hereof; or
- (b) materially modify the requirements as to those persons who are eligible to participate in the Plan;

provided, further, that no termination, amendment, modification or suspension of the Plan shall in any manner affect any Stock Option Agreement theretofore entered into pursuant to the Plan without the consent of the Participant or valid transferee of the Option.

### **Section 9.2 Public Offering**

In the event that prior to the expiration of any Option granted pursuant to this Plan, the Company shall undertake and complete a public offering (the "Public Offering") of the common stock of the Company in which the Company receives not less than seven million United States dollars (\$7,000,000.00), in exchange for such common stock, and following such Offering, not less than one million (1,000,000) shares of the Company's common stock are publicly held, the Participant shall have the right to exercise either in whole or in part any Options in which the Participant is vested or, pursuant to the provisions of any Stock



after the Public Offering not be subject to the repurchase or restriction provisions of the Plan provided for in Article VII hereof.

**ARTICLE X**  
**MISCELLANEOUS**

**Section 10.1 Employment**

Nothing in the Plan or in any Option granted hereunder or in any Stock Option Agreement relating thereto shall confer upon any Participant the right to continue to be retained or engaged as a consultant, independent contractor, employee, officer or director of the Company or any of its subsidiaries.

**Section 10.2 Other Compensation Plans**

The adoption of the Plan shall not affect any other stock option or incentive or other compensation plans in effect for the Company or any of its subsidiaries, nor shall the Plan preclude the Company from establishing any other forms of stock option plans or incentive or other compensation plans for employees, officers or directors of the Company or any of its subsidiaries.

**Section 10.3 No Prior Right of Offer**

Nothing in the Plan will be deemed to give or otherwise entitle any director, officer, or employee, or such individual's legal representatives or assigns, or any other person or entity claiming under or through such individual, any contractual or other right to participate in the Plan or otherwise receive any benefits under the Plan.

**Section 10.4 Liability of Company**

The Company's liability under this Plan and any sale made hereunder is limited to the obligations set forth with respect to such sale and nothing in this Plan will be construed to impose any liability on the Company in favor of the Participant with respect to any loss, cost, or expense which the Participant may incur in connection with, or arising out of, any transaction in connection therewith.

**Section 10.5 No Loans to Purchasers**

Neither the Company nor any subsidiary may directly or indirectly lend money to any Participant for the purpose of assisting such Participant to acquire shares of Stock subject to any Option granted pursuant to the Plan.

**Section 10.6 Plan Binding on Successors**

The Plan shall be binding upon the successors and assigns of the Company.

**Section 10.7 Singular, Plural; Gender**

Whenever used herein, nouns in the singular shall include the plural, and the masculine pronoun shall include the feminine gender.

**Section 10.8 Headings, Etc., No Part of Plan**

Headings of Articles and Sections hereof are inserted for convenience and references; they constitute no part of the Plan.

**Section 10.9 Investment Representation**

Each Stock Option Agreement shall contain an agreement that, upon demand by the Board for such a representation, the Participant shall deliver to the Board at the time of any exercise of an Option a written representation that the shares of Stock to be acquired upon such exercise are to be acquired for investment and not for resale or with a view to the distribution thereof. Upon such demand, delivery of such representation prior to the delivery of any shares issued upon exercise of an Option prior to the expiration of the Option period shall be a condition precedent to the right of the Participant or such other persons to purchase any such shares.

**Section 10.10 Compliance with Section 16 of the 1934 Act**

During any period in which the Company has a class of equity securities registered under Section 12 of the 1934 Act, and with respect to persons subject to Section 16 of the 1934 Act, transactions under this Plan are intended to comply with all applicable provisions of Section 16 of the 1934 Act and the rules promulgated thereunder (including without limitation, Rule 16b-3) or their successors under the 1934 Act. During any period in which the Company has a class of equity securities registered under Section 12 of the 1934 Act, to the extent any provision of the Plan or any Stock Option Agreement or any action by the Board fails to so comply, it shall be deemed null and void, to the extent permitted by law and deemed advisable by the Board, and it shall be restructured to the extent deemed advisable by the Board so to comply. By accepting Options granted under the Plan, a Participant shall be deemed to have consented to any modifications to the Plan or any Stock Option Agreement which the Board may deem desirable in order that the Plan or any Stock Option Agreement shall comply with Section 16 of the 1934 Act.

**Section 10.11 Compliance with Other Laws and Regulations**



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**AMENDMENT TO THE  
1996 NONQUALIFIED STOCK OPTION PLAN  
OF SHEARWATER POLYMERS, INC.**

THIS AMENDMENT TO THE 1996 NONQUALIFIED STOCK OPTION PLAN (the "Amendment") of Shearwater Polymers, Inc., an Alabama corporation (the "Company"), is made effective May 22, 1998 (the "Effective Date").

**W I T N E S S E T H:**

WHEREAS, on December 12, 1996, the Shareholders (the "Shareholders") of the Company and the Board of Directors of the Company (the "Board") unanimously adopted and authorized the Shearwater Polymers, Inc. 1996 Nonqualified Stock Option Plan (the "Plan"); and

WHEREAS, according to Section 9.1 of the Plan, the Board is empowered to amend or terminate the Plan at any time; and

WHEREAS, the Board now deems it advisable to amend the Plan regarding the eligible Participants under the Plan to include consultants and advisors.

NOW, THEREFORE, the Plan is hereby amended, as of the Effective Date, as follows:

**Section 1. Definitions.** Except as provided herein, all definitions of terms contained in the Plan are incorporated herein by reference.

**Section 2. Amendment of Section 1.1 (f).** Section 1.1(f) of the Plan is hereby amended and restated in its entirety as follows:

(f) "Key employees" means those employees, including officers, directors (including any nonemployee director), consultants and advisors of the Company or its subsidiaries who, in the judgment of the Board, directly or through the Committee, are considered (i) to be unusually valuable, (ii) to possess superior training, experience or ability, and/or (iii) to be actively interested in the development and financial success of the Company.

**Section 3. Amendment of Sections 2.2.** Section 2.2 is hereby amended by adding a new paragraph (d) as follows:

(d) Attract to the Company and to its subsidiaries and affiliates, directors (including any nonemployee director), consultants and advisors.

**Section 4. Amendment of Section 4.2.** The words "employment, death, retirement, disability, or other termination of employment" in Section 4.2 are hereby amended to read "employment, death, retirement, disability, or other termination of employment or engagement".

**Section 5. Amendment of Sections 6.4(c).** The words "director, officer, or full-time employee" in Section 6.4(c) are hereby amended to read "director, officer, full-time employee, consultant or advisor".

**Section 6. Amendment of Sections 6.6(a) and 7.2(g)(i)(1).** In each of Sections 6.6(a) and 7.2(g)(i)(1), the words "employment or directorship" are hereby amended to read "engagement (as a consultant or advisor), employment or directorship".

**Section 7. Amendment of Section 6.6(b).** The words "while such Participant is employed by" in Section 6.6(b) are hereby amended to read "while such Participant is employed or engaged by". In addition, the words "director, officer, or full-time employee" in Section 6.6(b) are hereby be amended to read as "director, officer, full-time employee, consultant or advisor".

**Section 8. Amendment of Section 7.1.** The words "employment or directorship" in Section 7.1 are hereby amended to read as "engagement (as a consultant or advisor), employment or directorship". In

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addition, the words "voluntary or involuntary termination of employment" in Section 7.1 are hereby amended to read "voluntary or involuntary termination of employment or engagement".

**Section 9. Amendment of Section 7.2(g)(ii).** The words "If the employment of the Participant" in Section 7.2(g)(ii) are hereby amended to read "If the employment or engagement of the Participant".

**Section 10. Amendment of Section 10.1.** The words "consultant, independent contractor, employee, officer or director of the Company" in Section 10.1 are hereby amended to read "consultant, advisor, independent contractor, employee, officer or director of the Company".

**Section 11. Amendment of Section 10.2.** The words "employees, officers or directors" in Section 10.2 are hereby amended to read "employees, officers, directors, consultants or advisors".

**Section 12. Amendment of Section 10.3.** The words "director, officer, or employee" in Section 10.3 are hereby amended to read "director, officer, employee, consultant or advisor".

**Section 13. Confirmation of Plan.** All the terms, covenants, and conditions of the Plan, as amended hereby, are hereby in all respects ratified and confirmed, and the Plan as so amended shall continue in full force and effect.

Adopted effective as of the 22nd day of May, 1998, by the Shareholders and Board of Directors of Shearwater Polymers, Inc.

/s/ J. MILTON HARRIS

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By: J. Milton Harris  
As Its President

ATTEST:

/s/ J. MILTON HARRIS

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J. Milton Harris  
As Its Secretary

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[AMENDMENT TO THE 1996 NONQUALIFIED STOCK OPTION PLAN OF SHEARWATER POLYMERS, INC.](#)

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**SECOND AMENDMENT TO THE  
1996 NONQUALIFIED STOCK OPTION PLAN  
OF SHEARWATER POLYMERS, INC.**

THIS SECOND AMENDMENT TO THE 1996 NONQUALIFIED STOCK OPTION PLAN (the "Second Amendment") of Shearwater Polymers, Inc., an Alabama corporation (the "Company"), is made effective February 26, 2000 (the "Effective Date").

**W I T N E S S E T H:**

WHEREAS, on December 12, 1996, the Shareholders (the "Shareholders") of the Company and the Board of Directors of the Company (the "Board") unanimously adopted and authorized the Shearwater Polymers, Inc. 1996 Nonqualified Stock Option Plan (the "Plan"); and

WHEREAS, on May 28, 1998, the Board adopted the first Amendment to the Plan (the "First Amendment");

WHEREAS, according to Section 9.1 of the Plan, the Board, with the approval of the shareholders of the Company, is empowered to amend the Plan to increase the total number of shares of common stock of the Company (the "Stock") subject to the Plan; and

WHEREAS, the Board and the shareholders now deem it advisable to further amend the Plan to increase the total number of shares of Stock subject to the Plan.

NOW, THEREFORE, the Plan is hereby amended, as of the Effective Date, as follows:

**Section 1. Definitions.** Except as provided herein, all definitions of terms contained in the Plan are incorporated herein by reference.

**Section 2. Amendment of Section 5.1.** The first sentence of Section 5.1 of the Plan is hereby amended and restated in its entirety as follows:

The number of shares of Stock which may be issued and sold hereunder shall not exceed 300,000 shares of Stock, subject to adjustment pursuant to the provisions of Section 5.3 hereof.

**Section 3. Confirmation of Plan.** All the terms, covenants, and conditions of the Plan, as amended by the First Amendment and as amended hereby, are hereby in all respects ratified and confirmed, and the Plan as so amended shall continue in full force and effect.

Adopted effective as of the 26th day of February, 2000, by the Shareholders and Board of Directors of Shearwater Polymers, Inc.

SHEARWATER POLYMERS, INC.

/s/ J. MILTON HARRIS

By: J. Milton Harris  
As Its President

ATTEST:

/s/ J. MILTON HARRIS

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J. Milton Harris  
As Its Secretary

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[SECOND AMENDMENT TO THE 1996 NONQUALIFIED STOCK OPTION PLAN OF SHEARWATER POLYMERS, INC.](#)

**THIRD AMENDMENT TO THE  
1996 NONQUALIFIED STOCK OPTION PLAN  
OF SHEARWATER POLYMERS, INC.**

THIS THIRD AMENDMENT (the "Third Amendment") to the 1996 Nonqualified Stock Option Plan of Shearwater Polymers, Inc., an Alabama corporation (the "Company"), is made effective October 5, 2000 (the "Effective Date").

**W I T N E S S E T H:**

WHEREAS, on December 12, 1996, the Shareholders (the "Shareholders") of the Company and the Board of Directors of the Company (the "Board") unanimously adopted and authorized the Shearwater Polymers, Inc. 1996 Nonqualified Stock Option Plan (the "Plan"); and

WHEREAS, on May 28, 1998, the Board adopted the first Amendment to the Plan (the "First Amendment"); and

WHEREAS, on February 26, 2000, the Board adopted the Second Amendment to the Plan (the "Second Amendment"); and

WHEREAS, on the 27th day of September, 2000, the Board and the shareholders approved the change of the name of the Company from "Shearwater Polymers, Inc." to "Shearwater Corporation"; and

WHEREAS, the name of the Company was changed from "Shearwater Polymers, Inc." to "Shearwater Corporation" on the 5th day of October, 2000; and

WHEREAS, the Board and the Shareholders now deem it advisable to further amend the Plan to reflect the name change of the Company.

NOW, THEREFORE, the Plan is hereby amended, as of the Effective Date, as follows:

**Section 1. Definitions.** Except as provided herein, all definitions of terms contained in the Plan are incorporated herein by reference.

**Section 2. Amendment of Sections 1(a)(k), Section 2.1, and Section 7.2(f).** In each of Section 1(a)(k), Section 2.1, and Section 7.2(f), the name "Shearwater Polymers, Inc." shall be deleted and in substitution therefore the name "Shearwater Corporation" shall be utilized.

**Section 3. Confirmation of Plan.** All the terms, covenants, and conditions of the Plan, as amended by the First Amendment, the Second Amendment, and as amended hereby, are hereby in all respects ratified and confirmed, and the Plan as so amended shall continue in full force and effect.

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Adopted effective as of the 5th day of October, 2000, by the Shareholders and Board of Directors of Shearwater Corporation.

SHEARWATER CORPORATION

/s/ J. MILTON HARRIS

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By: J. Milton Harris  
As Its President

ATTEST:

/s/ J. MILTON HARRIS

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J. Milton Harris  
As Its Secretary

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**FOURTH AMENDMENT TO THE  
1996 NONQUALIFIED STOCK OPTION PLAN  
OF SHEARWATER CORPORATION**

THIS FOURTH AMENDMENT (the "Fourth Amendment") to the 1996 Nonqualified Stock Option Plan of Shearwater Corporation, an Alabama corporation (the "Company") is made effective June 22, 2001.

**W I T N E S S E T H:**

WHEREAS, the Shareholders of the Company and the Board of Directors of the Company previously adopted the Shearwater Polymers, Inc. 1996 Nonqualified Stock Option Plan, as amended (the "Plan"); and

WHEREAS, the Company desires to amend the Plan to reflect certain modifications and clarifications contemplated by that certain Agreement and Plan of Merger and Reorganization, dated as of May 22, 2001, among Inhale Therapeutic Systems, Inc. ("Inhale"), Square Acquisition Corp., the Company, certain Shareholders of Shearwater Corporation, and J. Milton Harris, as amended (the "Merger Agreement").

NOW THEREFORE, the Plan is hereby amended, as of the date hereof, as follows:

**Section 1. Definitions.** Terms used herein but not otherwise defined shall have the same meaning as ascribed to them in the Plan.

**Section 2. Antidilution.** Section 5.3 of the Plan shall be amended to read in its entirety as follows:

**"Section 5.3 Antidilution**

(a) Subject to Section 5.3(e) hereof, in the event that the Stock is hereafter increased, decreased, or changed into or exchanged for a different number or kind of shares or other securities of the Company by reason of merger, consolidation, reorganization, recapitalization, reclassification, combination of shares, exchange of shares, stock split, or stock dividend after the effective date of the Plan:

(i) the aggregate number and kind of shares of Stock subject to Options which may be granted hereunder shall be adjusted appropriately; and

(ii) rights under outstanding Options granted hereunder, both as to the number of subject shares of Stock and the Option price, shall be adjusted appropriately.

(b) Subject to Section 5.3(e) hereof, in the event of a dissolution or liquidation of the Company, the Options granted hereunder shall terminate; provided, however, that the Participants shall have the right for a period of thirty (30) days prior to such dissolution or liquidation to exercise outstanding Options in full without regard to any installment exercise provisions and whether the Option by its terms is at such time immediately exercisable in full, to the extent it shall not have been exercised.

(c) With respect to Options granted hereunder, unless otherwise expressly provided in the applicable Stock Option Agreement, in the event of (i) any merger, consolidation, or combination involving the Company, including, without limitation, (A) any merger, consolidation, or combination that is solely for the purpose of changing the domicile of the Company, and (B) any merger, consolidation, or combination that would result in the holders of the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by the securities remaining outstanding or by being converted into voting securities of the surviving entity) more than fifty percent (50%) of the combined voting power of the voting securities of the

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Company (or such surviving entity) outstanding immediately after such merger, consolidation, or combination, or (ii) any sale of substantially all the assets of the Company or a sufficient amount of Stock in the Company (whether by tender offer, original issuance, or a single or series of related Stock purchase and sale agreements and/or transactions) sufficient to confer on the purchaser or purchasers thereof (whether individually or in a group) the ability to elect a majority of the Board of Directors of the Company, the Board or the board of directors of the surviving or acquiring entity (as used in this Section 5.3(d), also the "Board") shall, as to outstanding Options (on the same basis or on different bases, as the Board shall specify), make appropriate provision for the continuation of such Options by the Company or the assumption of such Options by the surviving or acquiring entity and by converting on an equitable basis for the shares then subject to such Options any one of the following: (a) the consideration payable with respect to the Stock in connection with a transaction described in (i) (including, without limitation, (i)(A) and (i)(B)) and (ii) above, (b) shares of stock of the surviving or acquiring corporation, (c) options in the shares of Stock of the surviving or acquiring corporation, (d) such other securities as the Board deems appropriate, the fair market value of which (as determined by the Board in its sole discretion) shall not materially differ from the fair market value of the shares of Stock subject to such Options immediately preceding a transaction described in (i) (including, without limitation, (i)(A) and (i)(B)) and (ii) above, or (e) any combination of the foregoing.

(d) The foregoing adjustments and the manner of application of the foregoing provisions shall be determined solely by the Board, and any such adjustment shall provide for the elimination of fractional share interests."

(e) Notwithstanding anything to the contrary in this Section 5.3, in the event that the transactions contemplated by that certain Merger Agreement that certain Agreement and Plan of Merger and Reorganization, dated as of May 22, 2001, among Inhale Therapeutic Systems, Inc., Square Acquisition Corp., the Company, certain Shareholders of Shearwater Corporation, and J. Milton Harris, as amended (the "Merger Agreement"), are consummated, then effective as of the effective time of the merger contemplated by the Merger Agreement, the Options then subject to the Plan shall be converted as provided in the Merger Agreement.

**Section 3. Elimination of Repurchase Rights.** Section 6.9 and Section 7.3 of the Plan are hereby deleted in their entirety.

**Section 4. Exercise Upon Termination.** Section 6.4(c) of the Plan is hereby deleted in its entirety, Section 6.6(a) of the Plan is hereby amended and restated in its entirety as follows:

"(a) If the engagement (as a consultant or advisor), employment, or directorship of a Participant to whom an Option shall have been granted pursuant to the Plan is terminated for any reason, other than death or total disability, such Participant shall have ninety (90) days from the date of such termination to exercise any such Option the Participant is entitled to exercise at the date of such termination; *provided, however*, upon the expiration of such ninety (90) day period following Participant's termination, all Options granted to such Participant to the extent not exercised prior to such expiration shall terminate."

**Section 5. Public Offering.** Section 9.2 of the Plan is hereby deleted in its entirety.

**Section 6. Confirmation of Plan.** All the terms, covenants and conditions of the Plan, as previously amended, and as amended hereby, are hereby in all respects ratified and confirmed, and the Plan as so amended shall continue in full force and effect.

**Section 7. Effective Time.** This Amendment shall be effective immediately upon the effective time of the merger contemplated by the Merger Agreement, and in the event the Merger Agreement is terminated, this Amendment shall be null and void and of no further force or effect.

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Adopted effective as of the 22nd day of June, 2001, by the Board of Directors of Shearwater Corporation.

SHEARWATER CORPORATION

/s/ J. MILTON HARRIS

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By: J. Milton Harris  
As Its: President

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[FOURTH AMENDMENT TO THE 1996 NONQUALIFIED STOCK OPTION PLAN OF SHEARWATER CORPORATION](#)

**SHEARWATER CORPORATION  
NONQUALIFIED STOCK OPTION AGREEMENT**

This Agreement is made and entered into effective as of the { } day of { }, 2001, by and between Shearwater Corporation (the "Company"), and {name} (the "Participant").

**RECITALS**

A. The Board of Directors of the Company (the "Board") has determined that the Participant, by reason of the Participant's position with the Company, is qualified for the grant of an Option pursuant to the Shearwater Corporation 1996 Nonqualified Stock Option Plan, as amended from time to time (the "Plan"), a copy of which is maintained by the Secretary in the files of the Company.

B. The Board pursuant to Article III of the Plan desires to grant to the Participant the Options described herein and has authorized the execution of this Agreement between the Company and the Participant.

NOW, THEREFORE, for and in consideration of the premises and the mutual promises contained herein, the parties hereto agree as follows:

1. *Grant of Options and Purchase of Shares.* Subject to the terms and conditions of the Plan and this Agreement, the Company has granted, and does hereby grant, unto the Participant the right and option to purchase from the Company an aggregate of {number} ({}00) shares of the Company's Common Stock ("Stock"), par value \$0.01 per share (the "Options"), from the authorized and unissued Stock of the Company, or at the election of the Company from reacquired Stock held as treasury stock, at and for a purchase price per share (the "Option Price") equal to \$0.10 per share.

2. *Exercise of Option.* Subject to the provisions of paragraph 3 of this Agreement and to any additional requirement set forth in the Plan, the Options shall be exercised by written notice of intent to exercise the Options with respect to a specified number of shares delivered to the Company at its principal office in the State of Alabama, execution of any buy-sell, shares redemption, cross purchase or other share agreement among, the Stockholders and the Company, which may be in existence from time to time, and payment in full to the Company at said office of the amount of the Option Price for the number of shares of Stock with respect to which the Options are then being exercised. The Option Price for the shares of Stock so purchased shall be payable in full in cash at the time of the exercise of the Options.

3. *Option Period and Vesting.* The Options may be exercised and Stock may be purchased by the Participant as the result of such exercise only within the periods and to the extent hereinafter set forth, namely:

(a) No part of the Options shall be exercisable before {same month and day}, 2001. From and after {same month and day}, 2001, the Options may be exercised in accordance with the following schedule:

(i) Options with respect to {number} ({}00) shares of Stock, representing { } percent ({} %) of the Options granted herein, shall become exercisable on or after {month and day}, 2001, but prior to the Time of Expiration;

(ii) Options with respect to an additional {number} ({}00) shares of Stock, representing { } percent ({} %) of the Options granted herein, shall become exercisable on or after {month and day}, 2002, but prior to the Time of Expiration;

(iii) Options with respect to an additional {number} ({}00) shares of Stock, representing { } percent ({} %) of the Options granted herein, shall become exercisable on or after {month and day}, 2003, but prior to the Time of Expiration;

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(iv) Options with respect to an additional {number} ({}00) shares of Stock, representing { } percent ({} %) of the Options granted herein, shall become exercisable on or after {month and day}, 2004, but prior to the Time of Expiration;

(b) At 5:00 P.M., Huntsville, Alabama time, on {month and day}, 2011, all right and option granted herein to purchase shares of Stock shall cease and terminate. The date and time of expiration of the Options shall be referred to hereinbefore and hereinafter as the "Time of Expiration." To the extent that any part of the Options are not exercised prior to the Time of Expiration, the right to purchase the shares of Stock shall expire and the shares of Stock covered thereby shall be considered released to the Company.

(c) Notwithstanding anything in this Agreement to the contrary, at least six months must elapse from the date of the grant of the Option to the date of the disposition of this Option or the underlying shares of Stock to which this Option relates, unless the Option shall become exercisable under paragraph 10 or unless the Board of Directors of the Company approves an earlier exercise of the Option or disposition of the underlying Stock.

4. *Conditions of Exercise.* Exercise the Options shall be conditioned on the following:

(a) No Option granted hereunder shall be exercisable unless at all times during the period beginning on the date of the granting of such Option and ending on the day which is the date of exercise (or ending on the day which is twelve (12) months before the date of exercise in the event of the total and permanent disability or death of an Participant) the Participant was a director, officer, or full-time employee of either the Company or a subsidiary of the Company, or a corporation (or parent or subsidiary of such corporation) issuing or assuming such Option in accordance with the terms of this Plan.

(b) For and in consideration of the right to receive and exercise the grant of the Options herein, the Participant agrees that while employed by the Company and, in the event of termination of employment (whether voluntarily or involuntarily), the Participant agrees that for a period of two (2) years following the termination of the Participant's employment with the Company or the sale of the Participant's Stock hereunder the Participant shall neither (i) compete with the Company in the Counties of Blount, Cherokee, Colbert, Cullman, DeKalb, Etowah, Franklin, Jackson, Lauderdale, Lawrence, Limestone, Madison, Marion, Marshall, Morgan, and Winston of the State of Alabama, and in any other state, county or country where the Company (or its subsidiaries or affiliates) conducts business, nor will the Participant engage or participate, directly or indirectly, in any business substantially similar to

the business of the Company including, but not limited to, engaging as an employee, consultant, advisor, partner, member, joint venturer, officer, director, agent, creditor, beneficial owner, or owner of record of any interest in a company or entity which would compete in any respect or be engaged in similar lines of business to the actual or proposed operations of the Company, nor (ii) disclose, directly or indirectly, any trade secrets of the Company, and shall not use them in any way, either during the term of this Agreement or at any time thereafter, except as required in the course of the Participant's employment by the Company or as may be expressly authorized in writing by the Company and the Participant specifically agrees that all files, records, documents, contracts, trade secrets, copyrights, patents, trade secrets, specifications, equipment, and similar items relating to the business of the Company, whether prepared by the Participant or otherwise coming into the Participant's possession, shall remain the exclusive property of the Company and shall not be removed from the premises of the Company under any circumstances whatsoever without the prior written consent of the Company and the Participant agrees to take reasonable precautions to protect such trade secrets from disclosure, theft, unauthorized publication or dissemination and that the Participant will not willfully commit any act or in any way assist another to commit any act for the purposes of injuring the Company and its affiliates nor will the Participant disclose any confidential information of the Company or make available to any others any documents, files, contracts, financial

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statements, or other papers concerning the business of the Company or its financial affairs, unless under order of a court of competent jurisdiction. For purposes of the foregoing, the term "trade secrets" shall include, without limitation: (i) all information, ideas, documents, supplier lists, pricing lists, contract formulas, patterns, devices, inventions, processes, compilations of information, records, and specifications; (ii) all such matters which are or may be patented or copyrighted; (iii) all matters marked "proprietary," "secret" or "confidential" and (iv) business plans of the Company, the operations and planned operations of the Company's facilities. If any of the foregoing provisions of this covenant relating to the duration, business or geographic scope shall be deemed to create a restriction which is unreasonable as to duration, business or geographic area, the Participant and the Company agree that such covenant shall be enforceable for such duration, business and geographic area as a court of competent jurisdiction determines to be reasonable. It is agreed that it would be impossible to fully compensate the Company for damages for breach of the obligations under this paragraph (b) of this paragraph 4, and that the Company would be irreparably harmed by breach of the obligations herein. Accordingly, the Participant and the Company specifically agree that the Company and any of its affiliates or successors shall be entitled to seek temporary and permanent injunctive relief to enforce the obligations herein and that such relief shall be in addition to other relief or damages available at law or equity and that such relief may be granted without the necessity of proving actual damages and to the extent permissible by applicable law, the parties agree that the Company shall not be required to post any bond to obtain such injunction relief. In addition to other rights granted herein, the Company is hereby specifically authorized to proceed in any court or courts of competent jurisdiction to obtain an injunction against any breach or threatened breach of the provisions of this paragraph (b) of this paragraph 4. The Participant and the Company agree that nothing contained herein is intended in any way to eliminate or otherwise reduce any of the rights or remedies to which the Company may be legally or equitably entitled; and the Company shall be entitled to recover from the Participant all costs, including attorneys' fees, incurred by the Company in undertaking to enforce any of the Company's rights under this paragraph (b) of this paragraph 4 or under any other paragraph of this Agreement; and the Company may also recover from Participant all profits, receipts, and the value of any benefits received by him, directly or indirectly, as a result of any violation of the foregoing provisions. The covenants contained in this paragraph (b) of this paragraph 4 shall be construed as agreements independent of other provisions of this Agreement and shall survive the termination of this Agreement and shall remain in full force and effect after said termination. It is expressly agreed that Participant may be working on behalf of the Company through the Company's subsidiaries and affiliated companies, and that all of the Company's subsidiaries and affiliated companies are direct and intended beneficiaries of the covenants made in this paragraph 4(b). Moreover, as used in this paragraph 4(b), the term, "the Company," shall include all subsidiaries and affiliates of the Company.

5. *Payment and Delivery of Certificates.* In case of any exercise of the Options, this Agreement accompanied by cash payment of the full purchase price for the shares of Stock then being purchased, shall be surrendered to the Company. The Company shall thereupon cause to be issued and delivered to the Participant, as soon as reasonably may be done, a certificate or certificates, representing the shares of Stock so purchased and fully paid, and shall endorse on this Agreement the fact that such Options have been exercised on such date and the extent of such exercise.

6. *Exercise of Options Upon Disability.* In the event that the Participant's employment by the Company or a subsidiary shall terminate because of his total and permanent disability (as defined in the first sentence of Section 72(m)(7) of the Code) and such Participant has not died within the following three months, the Options may be exercised, to the extent that the Participant shall have been entitled to do so at the date of the termination of the Participant's employment, by such Participant, or by such Participant's guardian, attorney-in-fact, or other person or persons authorized by

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law to act on behalf of the Participant, at any time, or from time to time, but not later than the Time of Expiration or one year after termination of employment, whichever date is earlier. From and after the Time of Expiration or one year following, the date of the Participant's termination of employment, whichever date is earlier, to the extent that any part of the Options are not so exercised, the right to purchase the shares of Stock shall expire and the shares of Stock covered thereby shall be considered released to the Company.

7. *Exercise of Options Upon Death of Participant.* In the event a Participant shall die (A) while an employee of the Company or (B) within three (3) months after termination of the Participant's employment with the Company if the termination of employment was due to his disability, the Participant's Options may be exercised, to the extent that the Participant shall have been entitled to do so on the date of the Participant's death or such termination of employment, by the person or persons to whom the Participant's right under the Option passed by will or applicable law, or if no such person has such right, the executors or administrators, at any time, or from time to time, but not later than the Time of Expiration or twelve (12) months after the Participant's death, whichever date is earlier. From and after the Time of Expiration or twelve (12) months following the date of the death of the Participant, whichever date is earlier, to the extent that any part of the Options is not so exercised, the right to purchase the shares of Stock shall expire and the shares of Stock covered thereby shall be considered released to the Company. No transfer of the Options by will or by the laws of descent and distribution shall be effective to bind the Company unless the Company shall have been furnished with written notice thereof and an authenticated copy of the will and/or such other evidence as the Board may deem necessary to establish the validity of the transfer, together with the acceptance by the transferee or transferees of the terms and conditions of such Options and the execution by the transferee or transferees of any then existing buy-sell agreement, shares redemption, cross purchase, or other share agreement among the Company and the Stockholders of the Company.

8. *Termination of Employment.* In the event a Participant's employment shall terminate for any reason other than the death or total and permanent disability of the Participant, all of the Participant's rights to exercise the Participant's Options granted herein shall terminate immediately upon such termination of employment.

9. *No Assignment.* The Options granted herein are personal to the Participant and may not in any manner or respect be assigned or transferred otherwise than pursuant to the provisions of paragraphs 6 or 7 hereof. Except to the extent permitted by the provisions of paragraphs 6 or 7 hereof, during the Participant's lifetime the Options granted herein are exercisable only by the Participant. To the extent the Options are not exercised, the shares of Stock covered thereby shall be considered released to the Company. In addition to the foregoing and except to the extent specifically permitted by the Plan, any Stock which is purchased pursuant to this Agreement shall not be assigned, transferred, sold, given, encumbered, or otherwise disposed of, voluntarily, involuntarily, by operation of law or otherwise and any such attempted assignment, transfer, sale, gift, encumbrance, or other disposition shall be void and of no effect and the Company shall not be required to recognize such attempted assignment, transfer, sale, gift, encumbrance or other disposition, but rather the Company shall have the right to repurchase such Stock in accordance with the terms of the Plan. To the extent any Options remain unexercised at the time of such attempted assignment, transfer, sale, gift, encumbrance or other disposition, such Options shall immediately terminate and the shares of Stock covered thereby shall be released to the Company.

10. *Public Offerings.* In the event that prior to the Time of Expiration the Company shall undertake and complete a public offering (the "Public Offering") of the common stock of the Company in which the Company receives not less than seven million United States dollars (\$7,000,000.00) in exchange for such common stock, and following such Public Offering, not less than one million (1,000,000) shares of the Company's common stock are publicly held, the Participant shall have the right to exercise either in whole or in part any Options in which the Participant is vested or, pursuant

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to the provisions of this Agreement, retain any vested and nonvested Options hereunder, and any Stock purchased by the Participant prior to the Public Offering shall immediately after the Public Offering not be subject to the repurchase and restriction provisions of Article VII of the Plan.

11. *Governed by Plan.* The Options granted herein and any Stock purchased pursuant to any such Options are in all respects subject to, and shall be governed and determined by, the provisions set forth in the Plan (a copy of which is attached hereto and all of the terms of which are incorporated herein by reference), as the same may be amended from time to time, and further, the Options are subject to any rules which might be adopted by the Board with respect thereto to the same extent and with the same effect as if set forth fully herein. All capitalized terms used in this Agreement and not defined herein shall have the meanings ascribed to them in the Plan unless the context herein otherwise requires.

12. *Participant's Representations.* In connection with the purchase of any Stock hereunder, the Participant hereby represents and warrants and shall be deemed to have represented and warranted as of the date of any such purchase, to the Company as follows:

(a) *Investment Intent: Capacity to Protect Interests.* The Participant is purchasing the Stock solely for said Participant's own account for investment and not with a view to or for sale in connection with any distribution of the Stock or any portion thereof and not with any present intention of selling, offering to sell or otherwise disposing of or distributing the Stock or any portion thereof in any transaction other than a transaction exempt from registration under all applicable federal, state, or local securities laws and regulations. The Participant also represents that the entire legal and beneficial interest of the Stock is being purchased, and will be held, for said Participant's account only, and neither in whole or in part for any other person. The Participant has a pre-existing business or personal relationship with the Company and its officers, directors and controlling persons and can be reasonably assumed to have the capacity to evaluate the merits and risks of an investment in the Company and to protect those interests in connection with this transaction.

(b) *Information Concerning the Company.* The Participant is a key employee (as defined in the Plan) and has heretofore discussed the Company and its plans, operations and financial condition with the Company's officers and has heretofore received all such information as said Participant has deemed necessary and appropriate to enable the said Participant to evaluate the financial risk inherent in making an investment in the Stock, and the Participant has received satisfactory and complete information concerning the business and financial condition of the Company in response to all inquiries in respect thereof.

(c) *Economic Risk.* The Participant realizes that the purchase of the Stock will be a highly speculative investment and involves a high degree of risk, and the Participant is able, without impairing his financial condition, to hold the Stock for an indefinite period of time and suffer a complete loss on the investment.

(d) *Restricted Securities.* The Participant understands and acknowledges that:

(i) the sale of the Stock has not been registered under the Securities Act of 1933 ("the Act") or the securities or blue sky laws of any state, and the Stock must be held indefinitely unless subsequently registered under the Act or an exemption from such registration is available and the Company is under no obligation to register the Stock;

(ii) the share certificates representing the Stock will be stamped with the legends specified in Section 14 hereof, and

(iii) the Company will make a notation in its record of the restrictions on transfer and legends hereunder.

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(e) The Participant represents and warrants that the Participant is a {n} {state or country} resident.

13. *Restrictions on Transfer.*

(a) The Participant agrees that none of the shares of Stock will be sold or otherwise disposed of by the undersigned unless and only to the extent expressly allowed by the Plan, by this Agreement, by the Shearwater 1996 Stock Option Plan Shareholders' Buy-Sell Agreement (as may be amended, revised or altered from time to time), and by any other buy-sell, cross purchase, shares redemption or other share agreement which may be required to be executed by the Company before the issuance of any stock pursuant hereto.

(b) The Participant further agrees that the restrictions on transfer contained in the Plan and in this Agreement shall also be deemed to apply to any shares of Stock issued to the Participant as the result of any stock split, reverse stock split, or other subdivision or combination of the Stock, stock dividend, recapitalization, merger or consolidation of the Company or the sale or conveyance to another person of all or substantially all of the assets of the Company.

(c) The Company shall not be required (i) to transfer on its books any shares of Stock which shall have been sold or transferred in violation of any of the provisions set forth in the Plan or this Agreement, or (ii) to treat as owner of such shares of Stock or to accord the right to vote as such owner or to pay dividends to any transferee to whom such shares of Stock shall have been so transferred.

14. *Legend.* Each certificate representing shares of the Company's Stock granted hereunder shall bear the following legend, or a legend substantially similar thereto, in addition to all other legends required to be set forth thereon by law or otherwise:

These securities have not been registered under the Securities Act of 1933 or the securities or blue sky laws of any state, and they may not be sold, offered for sale, transferred, assigned, pledged or otherwise disposed of in the absence of an opinion of counsel (which counsel and opinion shall be satisfactory to counsel for the Company) that such sale, offer for sale, transfer, assignment, pledge or other disposition does not violate the requirements of such Act and any applicable state securities laws, or any other applicable laws and regulations.

The right to transfer, sell, exchange, give, pledge, encumber or otherwise dispose of the shares of stock represented by this certificate is restricted in accordance with that certain Shearwater Corporation Nonqualified 1996 Stock Option Plan, as amended, and that certain Stock Option Agreement dated April 20, 2001, all as the same may be amended from time to time. Copies of the Plan and the Agreement are available for inspection at the offices of the Company.

The shares of Stock represented by this certificate are subject to the Shearwater Corporation's continuing right of first refusal and other rights to purchase and to all other terms, conditions, and restrictions of the Shearwater Corporation 1996 Nonqualified Stock Option Plan, as amended, a copy of which is on file and available for inspection during normal business hours at the Company's principal office.

The sale or transfer of this security is subject to certain restrictions set forth in the articles of incorporation and/or written agreements, copies of which may be obtained from the secretary of the corporation.

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15. *No Right to Employment, etc.* Nothing in this Agreement shall give the Participant any right to continue to be retained or engaged as a consultant, independent contractor, employee, officer or director of the Company or any of its subsidiaries.

16. *No Rights as Shareholders.* The Participant shall have no right as a stockholder of the Company with respect to any shares of Stock covered by the Participant's Option until the date of issuance of a stock certificate to the Participant for such shares of Stock. No adjustment shall be made for dividends (ordinary or extraordinary, whether in cash, securities or other property) or distributions or other rights for which the record date is prior to the date such stock certificate is issued, except as provided in the Plan.

17. *Withholding.* The Participant hereby consents to any withholding and other actions that the Company deems reasonably necessary to enable the Company to obtain the benefit of an income tax deduction under the Internal Revenue Code of 1986, as amended, and any related state or local income tax laws, in the amount of the difference between the Option exercise price of the Stock and its fair market value on the date of exercise or the lapse of a restriction, as applicable. The Participant agrees to notify the Company of any election which the Participant may make in respect thereto.

18. *Enforcement.* The Company shall have right and power specifically to enforce this Agreement and, without in any way limiting the foregoing, specifically to enforce the obligations of the Participant to sell the shares of Stock purchased by the Participant upon the exercise of the Option at the price and on the terms set forth in the Plan and in this Agreement.

19. *Miscellaneous.*

(a) This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, and all of which together shall be deemed to be one and the same instrument.

(b) At any time this Agreement may be amended, supplemented or otherwise modified, but only by an instrument in writing signed by the parties hereto.

(c) This Agreement and the legal relations among the parties hereto shall be governed by and construed in accordance with the laws of the State of Alabama. Any invalidity or unenforceability of any particular provision of this Agreement shall not affect the other provisions hereof, and this Agreement shall be construed in all respects as if such invalid or unenforceable provisions were omitted.

(d) The parties agree to execute such further instruments and to take such further action as may reasonably be necessary to carry out the intent of this Agreement.

(e) Any notice required or permitted hereunder shall be given in writing and shall be deemed effectively given upon personal delivery or upon deposit in the United States Post Office, by registered or certified mail with postage and fees prepaid, addressed to the Participant at the address shown on the Company's employment records and to the Company at the address of its principal corporate offices (attention: President) or at such other address as such party may designate by ten days' advance written notice to the other party hereto.

(f) This Agreement shall be binding upon and shall inure to the benefit of each of the parties hereto and their respective executors, administrators, personal representatives, legal representatives, heirs, and successors in interest.

20. *Termination of Agreement.* The right to purchase Stock pursuant to this Agreement shall terminate at the Time of Expiration.

21. *Approval of Plan by Shareholders.* The Plan pursuant to which this Agreement is executed was approved by the shareholders of the Company at the special meeting on the 12th day of December, 1996, and the amended and approved by the shareholders on the 28th day of May, 1998,

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and further amended and approved by the shareholders on February 26, 2000 and further amended and approved by the shareholders on October 5, 2000.

IN WITNESS WHEREOF, this Agreement has been executed by the Company and the Participant as of the date first above written.

ATTEST:

SHEARWATER CORPORATION

\_\_\_\_\_  
As Its Secretary

By: \_\_\_\_\_  
J. Milton Harris  
As Its President

WITNESS:

PARTICIPANT:

\_\_\_\_\_

\_\_\_\_\_

(name)

Pursuant to paragraph 2, record partial exercises below:

Date of Exercise	Number of Shares Purchased	Signature of Endorsing Officer of the Company	Signature of Participant
_____	_____	_____	_____

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[SHEARWATER CORPORATION NONQUALIFIED STOCK OPTION AGREEMENT](#)

**JUNE 2001 AMENDMENT TO  
SHEARWATER CORPORATION  
NONQUALIFIED STOCK OPTION AGREEMENT(S)**

THIS JUNE 2001 AMENDMENT TO SHEARWATER CORPORATION NONQUALIFIED STOCK OPTION AGREEMENT(S) (the "Amendment") is made as of the 29th day of June, 2001, by and between Shearwater Corporation (the "Company") and the undersigned optionholder (the "Participant").

**R E C I T A L S:**

WHEREAS, the Company and Participant are parties to that certain or those certain Shearwater Corporation Nonqualified Stock Option Agreement(s), as amended from time to time (the "Agreement");

WHEREAS, the Company desires to amend the Agreement to reflect certain modifications and clarifications contemplated by that certain Agreement and Plan of Merger and Reorganization, dated as of May 22, 2001, among Inhale Therapeutic Systems, Inc. ("Inhale"), Square Acquisition Corp., the Company, certain Shareholders of Shearwater Corporation, and J. Milton Harris, as amended (the "Merger Agreement"), on the terms and conditions contained herein.

NOW THEREFORE, for and in consideration of the premises and the mutual promises contained herein, the parties hereto agree as follows:

1. *Definitions.* Terms used herein but not otherwise defined shall have the same meaning as ascribed to them in the Agreement.
2. *Options Exercisable as of Effective Time.* The Agreement is hereby amended to add the following paragraph as *Section 3(d)* of the Agreement:

"(d) Notwithstanding anything to the contrary in this Agreement, the Options, to the extent not already exercisable as of the Effective Time (as hereinafter defined) and pursuant to the terms of this *Section 3*, shall immediately vest and become exercisable at the effective time (the "Effective Time") of the merger contemplated by that certain Agreement and Plan of Merger and Reorganization, dated as of May 22, 2001, among Inhale Therapeutic Systems, Inc. ("Inhale") Square Acquisition Corp., the Company, Certain Shareholders of Shearwater Corporation, and J. Milton Harris, as amended (the "Merger Agreement")."

3. *Termination of Employment.* *Section 4(a)* of the Agreement is hereby deleted in its entirety. *Section 8* of the Agreement is hereby amended and restated in its entirety as follows:

"8. *Termination of Employment.* If the engagement (as a consultant or advisor), employment, or directorship of a Participant to whom an Option shall have been granted pursuant to this Agreement is terminated for any reason, other than death or total and permanent disability, such Participant shall have ninety (90) days from the date of such termination to exercise any such Option the Participant is entitled to exercise at the date of such termination; *provided, however*, upon the expiration of such ninety (90) day period following Participant's termination, all Options granted to such Participant to the extent not exercised prior to such expiration shall terminate."

4. *Public Offerings.* *Section 10* of the Agreement is hereby deleted in its entirety.

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5. *Governed by Plan.* *Section 11* of the Agreement is hereby amended to add the following provision at the end of such *Section 11*:

"The parties hereby acknowledge and agree that in the event of a conflict between the terms and provisions of this Agreement and the Plan, the terms and provisions of the Plan shall govern."

6. *No other Amendments.* Except as amended hereby, the Agreement shall remain in full force and effect, shall be binding on the parties in accordance with their respective terms and are hereby ratified and confirmed. The Participant hereby agrees that this Agreement amends each and every Stock Option Agreement between the Participants and the Company.

7. *Additional Agreements.* Participant hereby consents to the Fourth Amendment to Plan, attached hereto as Attachment A, and acknowledges and agrees that Options shall be subject to the Plan as so amended. Participant further acknowledges that (i) the Options will be converted in accordance with the Merger Agreement if the merger contemplated thereby is consummated; and (ii) the cash component in connection with such conversion may be subject to applicable withholdings by the Company. Participant further agrees not to (and waives his or her right, if any, to) exercise Participant's Options prior to the Effective Time.

8. *Effective Time of Amendment.* This Amendment shall be effective immediately upon the effective time of the merger contemplated by the Merger Agreement, and in the event the Merger Agreement is terminated, this Amendment shall be null and void and of no further force or effect. Except as set forth above in this Paragraph 8, this Amendment shall be irrevocable by Participant.

9. *Counterparts.* This Amendment may be executed in any number of counterparts, each of which shall be deemed to be an original, but all of which together shall constitute but one and the same instrument.

IN WITNESS WHEREOF, Participant has hereunto set his or her hands, and the Company has caused this Agreement to be executed by its duly authorized officer, all effective as of the day and year first above written.

PARTICIPANT

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Print name: \_\_\_\_\_



SHEARWATER CORPORATION

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By: J. Milton Harris  
As Its: President

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[JUNE 2001 AMENDMENT TO SHEARWATER CORPORATION NONQUALIFIED STOCK OPTION AGREEMENT\(S\)](#)