

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the  
Securities Exchange Act of 1934

March 5, 1998  
Date of Report (Date of earliest event reported)

DISCOVERY LABORATORIES, INC.  
(Exact name of Registrant as specified in its charter)

Delaware  
(State or other  
jurisdiction  
of incorporation)

000-26422  
(Commission File Number)

94-3171943  
(IRS Employer  
Identification Number)

509 Madison Avenue, 14th Floor  
New York, New York 10022  
(Address of principal executive offices)

(212) 223-9504  
(Registrant's telephone number, including area code)

Item 5. Other Events

Discovery Laboratories, Inc. (the "Registrant"), ATI Acquisition Corp. ("Acquisition Corp.") and the Registrant's majority-owned subsidiary, Acute Therapeutics, Inc. ("ATI"), have entered into an Agreement and Plan of Merger (the "Merger Agreement") dated as of March 5, 1998. Pursuant to the Merger Agreement, the Registrant will acquire all outstanding shares of the common stock, par value \$0.001 per share, of ATI ("ATI Common Stock") through a merger of Acquisition Corp. into ATI (the "Merger"). The Registrant and ATI have also entered into a Management Agreement dated as of March 5, 1998 (the "Management Agreement") providing for the management of the Registrant by the ATI management team pending completion of the Merger. Pursuant to the Management Agreement, members of the ATI management team have been granted options to purchase 126,500 shares of the Registrant's Common Stock, par value \$0.001 per share ("Registrant Common Stock"), subject to vesting.

The Merger Agreement provides that the stockholders of ATI will be issued 3.91 shares of Registrant Common Stock in exchange for each share of ATI Common Stock held by the stockholders of ATI prior to the Merger (the "Exchange Ratio"). Certain outstanding ATI options for the purchase of ATI Common Stock will be assumed by the Registrant and will become exercisable for Registrant Common Stock on the basis of the Exchange Ratio. In addition, pursuant to employment agreements to be entered into with the Registrant, the ATI management team will be granted, in the aggregate, options to purchase (i) 338,500 shares of Registrant Common Stock, subject to vesting, (ii) 175,000 shares of Registrant Common Stock at such time as the market capitalization of the Registrant exceeds \$75 million and (iii) 160,000 shares of Registrant Common Stock upon consummation of a corporate partnering deal having a total value of at least \$20 million. The Registrant Common Stock to be issued to ATI stockholders and the ATI options to be assumed in the Merger, together with the options to be issued to ATI management members pursuant to their employment agreements with the Registrant and the options granted pursuant to the Management Agreement, will represent approximately 24% of the Registrant Common Stock on a fully-diluted basis.

The closing of the Merger, which is expected to occur as soon as practicable after the Registrant's Annual Meeting of Stockholders, is subject to customary closing conditions, including approval by the stockholders of the Registrant and ATI. The Merger is further conditioned upon, among other things, (i) the execution of employment agreements by Robert J. Capetola, Ph.D., currently Chief Executive Officer of ATI, and other key executives of ATI and (ii) the election at the Annual Meeting of a Board of Directors of the Registrant consisting of six of the Registrant's current directors (three of

whom are also directors of ATI) and four of ATI's current directors.

Item 7. Financial Statements, Pro Forma Financial Statements and Exhibits

(c) Exhibits:

- 2.1 Agreement and Plan of Merger among Discovery Laboratories, Inc., ATI Acquisition Corp. and Acute Therapeutics, Inc. dated as of March 5, 1998.
- 2.2 Form of Registration Rights Agreement between Discovery Laboratories, Inc., Johnson & Johnson Development Corporation and The Scripps Research Institute.
- 2.3 Form of Lock-up Agreement.
- 10.1 Management Agreement between Discovery Laboratories, Inc. and Acute Therapeutics, Inc. dated as of March 5, 1998.
- 99.1 Press Release dated March 10, 1998.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Date: March 10, 1998

DISCOVERY LABORATORIES, INC.

By: /s/ James S. Kuo

-----  
Name: James S. Kuo, M.D.

Title: Chief Executive Officer

Exhibit Index

Exhibit Number -----	Description -----
2.1	Agreement and Plan of Merger
2.2	Form of Registration Rights Agreement
2.3	Form of Lock-up Agreement
10.1	Management Agreement
99.1	Press Release dated March 10, 1998

## AGREEMENT AND PLAN OF MERGER

among

DISCOVERY LABORATORIES, INC.

ATI ACQUISITION CORP.

AND

ACUTE THERAPEUTICS, INC.

March 5, 1998

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- Exhibit F - Form of Registration Rights Agreement
- Exhibit G - Form of Investment Agreement
- Exhibit H - Form of Lock-up Agreement
- Exhibit I - Form of Buyer 1998 Stock Option Plan



AGREEMENT AND PLAN OF MERGER

AGREEMENT AND PLAN OF MERGER, dated March 5, 1998, by and among Discovery Laboratories, Inc., a Delaware corporation ("Buyer" or "Discovery"), ATI Acquisition Corp., a Delaware corporation and a wholly-owned subsidiary of Buyer ("Acquisition Subsidiary"), and Acute Therapeutics, Inc., a Delaware corporation ("Seller" or "Acute").

RECITALS:

WHEREAS, upon and subject to the terms and conditions of this Agreement, Acquisition Subsidiary will merge with and into Seller (the "Merger") and Seller will become a wholly-owned subsidiary of Buyer;

WHEREAS, the Boards of Directors of Seller and Buyer have each determined that it is in the best interests of their respective stockholders for Buyer to acquire Seller upon the terms and subject to the conditions set forth herein; and

WHEREAS, also in furtherance of such acquisition, the Boards of Directors of Seller and Buyer have each approved this Agreement and the Merger of Acquisition Subsidiary with and into Seller in accordance with the Delaware General Corporation Law ("DGCL"), and upon the terms and subject to the conditions set forth herein; and

WHEREAS, the Board of Directors of Seller has resolved to recommend approval of this Agreement and the Merger to the holders of shares of Seller's Common Stock, \$0.001 par value per share (the "Common Shares") and the holder of shares of Seller's Series A Preferred Stock, \$0.001 par value per share (the "Series A Acute Preferred Shares");

WHEREAS, for federal income tax purposes it is intended that the Merger qualify as a reorganization under the provisions of Section 368(a) of the United States Internal Revenue Code of 1986, as amended (the "Code"); and

NOW, THEREFORE, in consideration of the foregoing and the mutual covenants and agreements herein contained, and intending to be legally bound hereby, Seller, Buyer and Acquisition Subsidiary hereby agree as follows:

## ARTICLE 1

### THE MERGER

Section 1.1 The Merger. Subject to the terms and conditions of this Agreement, at the Effective Time (as defined in Section 1.2 hereof), Seller and Acquisition Subsidiary shall consummate the Merger pursuant to which Acquisition Subsidiary shall be merged with and into Seller in accordance with Section 251 of the DGCL, the separate corporate existence of Acquisition Subsidiary shall cease, and Seller shall continue as the surviving corporation in the Merger (Seller is sometimes referred to as the "Surviving Corporation").

Section 1.2 Closing and Effective Time. The closing of the Merger (the "Closing") shall take place (i) at 10:00 a.m., New York time, on a date to be specified by the parties, which shall be no later than the fifth business day after satisfaction or waiver of all of the conditions set forth in Article 6 hereof, at the offices of Brobeck, Phleger & Harrison LLP, 1633 Broadway, 47th Floor, New York, NY 10019 or (ii) at such other time and place as Buyer and Seller shall agree (the "Closing Date"). Immediately after completion of the Closing, the parties shall cause the Merger to be consummated by filing a certificate of merger (the "Certificate of Merger") executed in accordance with the relevant provisions of the DGCL and shall make all other filings or recordings required under the DGCL. The Merger shall become effective at the time when the Certificate of Merger has been duly filed with the Delaware Secretary of State, or such time as is agreed upon by the parties and specified in the Certificate of Merger, and such time is hereinafter referred to as the "Effective Time." The date of the Effective Time is hereinafter referred to as the "Effective Date."

Section 1.3 Directors and Officers of the Surviving Corporation. The directors and officers of Seller at the Effective Time shall be the initial directors and officers, respectively, of the Surviving Corporation.

Section 1.4 Certificate of Incorporation. The certificate of incorporation of Acquisition Subsidiary in effect at the Effective Time shall be the certificate of incorporation of the Surviving Corporation until amended in accordance with applicable law.

Section 1.5 Bylaws. The bylaws of Acquisition Subsidiary in effect at the Effective Time shall be the bylaws of the Surviving Corporation until amended in accordance with applicable law.

Section 1.6 Effect of the Merger. At the Effective Time, the effect of the Merger shall be as provided in the applicable provisions of the DGCL. Without limiting the generality of the foregoing, and subject thereto, at the Effective Time all the property, rights, privileges, powers and franchises of Seller and Acquisition Subsidiary shall vest in the Surviving Corporation, and all debts, liabilities and duties of Seller and Acquisition Subsidiary shall become the debts, liabilities and duties of the Surviving Corporation.

## ARTICLE 2

### CONVERSION OR EXCHANGE OF SECURITIES

Section 2.1 Conversion of Capital Stock. As of the Effective Time, by virtue of the Merger and without any action on the part of Buyer, Acquisition Subsidiary, Seller, or the holders of any Common Shares or Series A Acute Preferred Shares or Series B Acute Preferred Shares (as herein defined) or any shares of capital stock of Acquisition Subsidiary:

(a) Acquisition Subsidiary Capital Stock. Each issued and outstanding share of capital stock of Acquisition Subsidiary shall be converted into and become one fully paid and nonassessable share of common stock of the Surviving Corporation.

(b) Cancellation of Treasury Stock and Series A Acute Preferred Shares. All Common Shares that are owned by Seller and all Series A Acute Preferred Shares that are owned by Buyer shall be cancelled and extinguished without any conversion thereof and no consideration shall be delivered in exchange therefor.

(c) Conversion of Common Shares. Each issued and outstanding Common Share (other than Common Shares to be canceled in accordance with Section 2.1(b) and any dissenting Common Shares which are held by stockholders exercising appraisal rights pursuant to the DGCL ("Dissenting Stockholders")) shall by virtue of the Merger and without any action on the part of the holder thereof, be automatically converted into the right to receive, upon surrender of the certificate formerly representing such Common Share (the "Common Share Certificate") in the manner provided in Section 2.3 below, 3.91 shares of Common

Stock, \$.001 par value of Buyer ("Buyer Common Stock"). The number of shares of Buyer Common Stock into which each Common Share will be automatically converted is referred to as the "Conversion Ratio." All such Common Shares, when so converted, shall no longer be outstanding and shall automatically be canceled and retired and shall cease to exist, and each holder of a certificate representing any such Common Shares shall cease to have any rights with respect thereto, except the right to receive the merger consideration therefor upon the surrender of such certificate in accordance with Section 2.3, or, in the case of Dissenting Stockholders, the right, if any, to receive payment from the Surviving Corporation of the fair value of such Common Shares as determined in accordance with the DGCL. No fractional shares of Buyer Common Stock shall be issued and, in lieu thereof, a cash payment shall be made pursuant to Section 2.3(c).

Section 2.2 Exchange of Series B Acute Preferred Shares. Each issued and outstanding Share of Seller's Series B Preferred Stock, \$0.001 par value per share (the "Series B Acute Preferred Shares") shall, at the Closing, be exchanged for one share of Series A Preferred Stock, \$0.001 par value per share of Buyer (the "Discovery Preferred Shares"), pursuant to an exchange agreement between Buyer

and Johnson & Johnson Development Corporation ("JJDC")(the "Exchange Agreement") in form and substance reasonably acceptable to Buyer and Seller.

### Section 2.3 Payment for Common Shares; Surrender of Certificates

(a) Letter of Transmittal. As soon as practicable after the Effective Time, Buyer will send to each record holder of Common Shares at the Effective Time a letter of transmittal and other appropriate materials for use in surrendering Common Share Certificates to Buyer's transfer agent, who shall be appointed exchange agent with respect to the Merger (the "Exchange Agent").

(b) Payment Procedures. Promptly after the Effective Time, Buyer shall request that the Exchange Agent distribute to each former holder of Common Shares, upon surrender to the Exchange Agent of one or more Common Share Certificates for cancellation together with a duly executed and properly completed letter of transmittal, the shares of Buyer Common Stock receivable by such holder in accordance with the provisions of Section 2.1(c). If Buyer Common Stock is to be delivered to a person other than the person in whose name a Common Share Certificate is so registered, the Common Share Certificate is so surrendered shall be properly endorsed, with signatures guaranteed, or otherwise in proper form for transfer, and the person requesting such payment shall pay any transfer or other taxes required by reason of the delivery to a person other than the registered holder of such Common Share Certificate surrendered, or such person shall establish to the satisfaction of Buyer that such tax has been paid or is not applicable. No interest shall be paid on any consideration payable in the Merger to former holders of Common Shares.

(c) No Fractional Shares.

- (i) No fractional shares of Buyer Common Stock shall be issued as a result of the Merger. In lieu of the issuance of fractional shares, cash adjustments will be paid to the former holder of Common Shares in respect of any fraction of a share of Buyer Common Stock which would otherwise be issuable under this Agreement. Such cash adjustment shall be equal to an amount determined by multiplying (A) the fractional share of Buyer Common Stock to which the holder of Seller Common Stock would be otherwise entitled under Section 2.1(c) (after aggregating all shares of Buyer Common Stock to which such holder is entitled), by (B) the average closing price of shares of Buyer Common Stock on The Nasdaq Small Cap Market for the twenty trading days immediately preceding the Effective Date.
- (ii) As soon as practicable after the determination of the amount of cash, if any, to be paid to former holders of Common Shares with respect to any fractional share interests of Buyer Common Stock, the Exchange Agent shall promptly pay such amounts to such former holders of Common Shares subject to and in accordance with the terms of this Section 2.3. Buyer will make available to the Exchange Agent the cash necessary for this purpose.

Section 2.4 Appraisal Rights. Notwithstanding any other provision of this Agreement to the contrary, including but without limitation Section 6.3(f), Common Shares held by a holder who has not voted such Common Shares in favor of the approval of this Agreement and the Merger or consented thereto in writing and with respect to which appraisal rights shall have been demanded and perfected in accordance with Section 262 of the DGCL (the "Dissenting Common Shares") and as of the Effective Time not withdrawn shall not be converted into the right to receive the consideration payable pursuant to Section 2.1(c) at or after the Effective Time, but such Common Shares shall become the right to receive such consideration as may be determined to be due to holders of Dissenting Common Shares pursuant to the laws of the State of Delaware unless and until the holder of such Dissenting Common Shares withdraws his or her demand for such appraisal or becomes ineligible for such appraisal. If a holder of Dissenting Common Shares shall withdraw his or her demand for such appraisal or shall become ineligible for such appraisal (through failure to perfect or otherwise), then, as of the Effective Time or the occurrence of such event, whichever last occurs, such holder's Dissenting Common Shares shall automatically be converted into and represent the right to receive the merger consideration as provided in Section 2.1(c). Seller shall give Buyer (i) prompt written notice of any demands for appraisal of Common Shares received by Seller and (ii) the opportunity to participate in and direct all negotiations and proceedings with respect to any such demands. Seller shall not, without prior written consent of Buyer, make any payment with respect to, or settle, offer to settle or otherwise negotiate, any such demands.



## Section 2.5 Seller Option Plan.

(a) Assumption of Options. Each outstanding option to purchase Common Shares issued to employees, non-employee directors and consultants of Seller pursuant to Seller's 1996 Stock Option/Stock Issuance Plan, as amended (the "Seller Option Plan"), except for options to purchase 44,800 Common Shares granted on October 10, 1996, as listed on Schedule 2.5 hereto which shall terminate on the Closing, whether vested or unvested (each a "Stock Option"), shall remain outstanding after the Effective Time and shall be assumed by Buyer. The parties intend that Buyer's assumption of the Stock Options shall be treated as "assuming a stock option in a transaction to which Section 424(a) applies" within the meaning of Section 424 of the Code and this subsection (a) shall be interpreted and applied consistent with such intent. Each Stock Option assumed by Buyer shall be exercisable upon the same terms and conditions as under the Seller Option Plan and applicable option agreement issued thereunder, except that (i) such option shall be exercisable for that number of shares of Buyer Common Stock equal to the number of Common Shares for which such option was exercisable times the Conversion Ratio, and (ii) the exercise price of such option shall be equal to the exercise price of such option divided by the Conversion Ratio. The number of shares of Buyer Common Stock subject to an option assumed by Buyer shall be rounded to the nearest whole number (with .5 rounded up) and the exercise price thereof shall be rounded up to the nearest whole cent.

(b) Notice. As soon as practicable after the Effective Time, Buyer shall deliver to the holders of Stock Options appropriate notices setting forth such holders' rights pursuant to the Buyer Option Plan (as defined in Section 4.2 hereof). The agreements evidencing the grants of such Stock Options shall continue in effect on the same terms and conditions (subject to the adjustments required by this Section 2.5 after giving effect to the Merger).

## ARTICLE 3

### REPRESENTATIONS AND WARRANTIES OF SELLER

Seller represents and warrants to Buyer and Acquisition Subsidiary as follows:

#### Section 3.1 Organization.

(a) Except as set forth in Section 3.1 of the disclosure schedule delivered to Buyer on or before the date hereof (the "Seller Disclosure Schedule"), Seller is a corporation duly organized, validly existing and in good standing under the laws of Delaware and has the requisite corporate power and authority and any necessary governmental authority to own, operate or lease the properties that it purports to own, operate or lease and to carry on its business as it is now being conducted, and, except as set forth in Section 3.1 of the Seller Disclosure Schedule, is duly qualified as a foreign corporation to do business, and is in good standing, in each jurisdiction where the character of its properties owned, operated or leased or the nature of its activities makes such qualification necessary, except for such failure which, when taken together with all other such failures, would not have a Seller Material Adverse Effect (as defined below in Section 3.1(b)). Seller does not own or control any subsidiary.

(b) The term "Seller Material Adverse Effect" means any individual material adverse effect, or adverse effects which in the aggregate (whether or not related and whether or not any individual effect is material) have a material adverse effect, on the business, operations, properties (including intangible properties), condition (financial or otherwise), assets or liabilities of Seller or could reasonably be expected to prevent or materially delay the consummation of the Merger.

#### Section 3.2 Capitalization.

(a) Capitalization. The authorized capital stock of Seller consists of 2,000,000 Common Shares, par value \$0.001 per share and 1,000,000 shares of Preferred Stock, \$0.001 par value per share, of which 600,000 shares are designated Series A Acute Preferred Shares and 2,200 shares are designated Series B Acute Preferred Shares. The outstanding Series A Acute Preferred Shares are convertible into 600,000 shares of Common Shares at the conversion price in effect with respect thereto. The Series B Acute Preferred Shares are not convertible. As of December 31, 1997, (i) 202,000 Common Shares were issued and outstanding, (ii) 600,000 Series A Acute Preferred Shares were issued and outstanding and were convertible into 600,000 Common Shares, (iii) 2,039 Series B Acute Preferred Shares were issued and outstanding and held by JJDC, (iv) no shares of Common Stock were held in the treasury of Seller, and (v) 202,300

Common Shares were reserved for issuance upon exercise of outstanding options under the Seller Option Plan. Section 3.2 of the Seller Disclosure Schedule sets forth a true and correct list as of December 31, 1997 of all holders of options to purchase Common Shares, the number of such options outstanding as of such date and the exercise price per option. All of the outstanding shares of Common Shares have been duly authorized and validly issued and are fully paid and nonassessable and free of preemptive rights. Except as set forth in this Section 3.2 and in Section 3.2 of the Seller Disclosure Schedule, there are no other options, warrants or other rights, convertible debt, agreements, arrangements or commitments of any character obligating Seller to issue or sell any shares of capital stock of or other equity interests in Seller. Seller is not obligated to redeem, repurchase or otherwise reacquire any of its capital stock or other securities.

(b) Seller does not directly or indirectly own or have a right to acquire an equity interest in any corporation, partnership, joint venture or other business association or entity.

Section 3.3 Authorization; Validity of Agreement; Necessary Action. Seller has full corporate power and authority to execute and deliver this Agreement, all agreements to which Seller is or will be a party that are exhibits to this Agreement and the Management Agreement of even date herewith between Buyer and Seller (the "Management Agreement") and to consummate the transactions contemplated hereby and thereby. The execution, delivery and performance by Seller of this Agreement and such other agreements and the consummation of the Merger and of the other transactions contemplated hereby and thereby, have been duly authorized by the Board of Directors of Seller and no other corporate or stockholder action on the part of Seller is necessary to authorize the execution and delivery by Seller of this Agreement and such other agreements and the consummation of the transactions contemplated hereby and thereby (other than the approval of this Agreement and the Merger by the holders of a majority of the outstanding shares of Seller capital stock entitled to vote with respect thereto). This Agreement and such other agreements have been duly executed and delivered by Seller and, assuming due and valid authorization, execution and delivery hereof by the other parties thereto are valid and binding obligations of Seller, enforceable against Seller in accordance with its terms.

Section 3.4 Consents and Approvals; No Violations. Except for the filings or the consents, authorizations or approvals under the agreements set forth in Section 3.4 of the Seller Disclosure Schedule and the filings, permits, authorizations, consents and approvals as may be required under, and other applicable requirements of, the Securities Exchange Act of 1934 (the "Exchange Act"), the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"), state securities or blue sky laws, the DGCL and the filing and recordation of a Certificate of Merger under the DGCL, neither the execution, delivery or performance of this Agreement by Seller nor the consummation by Seller of the transactions contemplated hereby nor compliance by Seller with any of the provisions hereof will (i) conflict with or result in any breach of any provision of the certificate of incorporation or the bylaws of Seller, (ii) require any filing with, or permit, authorization, consent or approval of any court, arbitration tribunal, administrative agency or commission or other governmental or other regulatory authority or agency, domestic or foreign (a "Governmental Entity") on the part of Seller, (iii) require the consent of any person under, result in a violation or breach of, or constitute (with or without due notice or lapse of time or both) a default (or give rise to any right of termination, amendment, cancellation or acceleration) under, any of the terms, conditions or provisions of any note, bond, mortgage, indenture, lease, license, contract, agreement or other instrument or obligation to which Seller is a party or by which Seller or any of its properties or assets may be bound (the "Seller Specified Agreements"), the lack of which consent, or which violation, breach or default, individually or in the aggregate, could reasonably be expected to have a Seller Material Adverse Effect or (iv) violate any order, writ, injunction, decree, statute, rule or regulation applicable to Seller, any of its subsidiaries or any of their properties or assets.

Section 3.5 [RESERVED]

Section 3.6 Absence of Certain Changes. Since December 31, 1997, except as contemplated by this Agreement, there has not been:

- (a) any Seller Material Adverse Effect;
- (b) any material damage, destruction or loss (whether or not covered by insurance) with respect to any of the material assets of Seller;
- (c) any issuance, redemption or acquisition of capital stock by Seller or any declaration or payment of any dividend or other distribution in cash, stock or property with respect to capital stock;
- (d) any stock split, reverse stock split, combination, reclassification or other similar action with respect to capital stock;
- (e) any entry into any material commitment or transaction (including, without limitation, any borrowing or capital expenditure) other than in the ordinary course of business or as contemplated by this Agreement;
- (f) any acquisition or disposition of rights (pursuant to license, sublicense or otherwise) under or with respect to any patent, copyright, trademark, tradename or other intellectual property right or registration thereof or application therefor;
- (g) any mortgage, pledge, security interest or imposition of lien or other encumbrance on any material asset of Seller; or
- (h) any change by Seller in accounting principles or methods except



insofar as may have been required by a change in generally accepted accounting principles and disclosed in the Buyer Financial Statements (as defined in Section 4.5 below).

Except as set forth in Section 3.6 of the Seller Disclosure Schedule, since December 31, 1997 Seller has conducted its business only in the ordinary course and in a manner consistent with past practice and has not made any material change in the conduct of its business or operations. Except as set forth in Section 3.6 of the Seller Disclosure Schedule, no person has or will have the right to receive any severance, bonus, other payment, increase or change in benefits or vesting of stock options, shares or other benefits as a result of any of the transactions contemplated by this Agreement.

Section 3.7 No Undisclosed Liabilities. Except as set forth in Section 3.7 of the Seller Disclosure Schedule, and except as

reflected in the Buyer Financial Statements, Seller has no liabilities of any nature (whether accrued, absolute, contingent or otherwise), except those liabilities incurred in the ordinary course of business which could not, individually or in the aggregate, reasonably be expected to have a Seller Material Adverse Effect.

Section 3.8 Litigation. Except as disclosed in Section 3.8 of the Seller Disclosure Schedule, there is no suit, claim, action, proceeding or investigation pending or, to the knowledge of Seller, threatened against Seller. Except as disclosed in Section 3.8 of the Seller Disclosure Schedule, Seller is not subject to any outstanding order, writ, injunction or decree.

Section 3.9 No Default; Compliance with Applicable Laws. The business of Seller is not being conducted in default or violation of any term, condition or provision of (i) its certificate of incorporation or bylaws, (ii) any Seller Specified Agreement or (iii) any federal, state, local or foreign statute, law, ordinance, rule, regulation, judgment, decree, order, concession, grant, franchise, permit or license or other governmental authorization or approval applicable to Seller, excluding from the foregoing clauses (ii) and (iii), defaults or violations which could not, individually or in the aggregate, reasonably be expected to have a Seller Material Adverse Effect. As of the date of this Agreement, no investigation or review by any Governmental Entity or other entity with respect to Seller is pending or, to the knowledge of Seller, threatened, nor has any Governmental Entity or other entity indicated an intention to conduct the same. Seller has in effect all Federal, state, local and foreign governmental approvals, authorizations, certificates, filings, franchises, licenses, notices, permits and rights ("Seller Permits") necessary for it to own, lease or operate its properties and assets and to carry on its business as now conducted, and there has occurred no default under any such Seller Permit.

Section 3.10 Intellectual Property. Except as set forth in Section 3.10 of the Seller Disclosure Schedule, or as could not reasonably be expected to have, individually or in the aggregate, a Seller Material Adverse Effect, Seller owns or possesses adequate licenses or other valid rights to use all patents, trademarks, trade names, copyrights, service marks, trade secrets, know-how and other proprietary rights and information used or held for use in connection with the business of Seller as currently conducted, and Seller is unaware of any assertion or claim challenging the validity of any of the foregoing. Section 3.10 of the Seller Disclosure Schedule lists all material licenses, sublicenses and other agreements to which Seller is a party and pursuant to which (i) any third party is authorized to use any intellectual property right of Seller and (ii) Seller is authorized to use any intellectual property rights (other than pursuant to shrink-wrap licenses and other software licenses) of a third party, true and correct copies of which have been provided to Buyer and Acquisition Subsidiary. The conduct of the business of Seller as currently conducted does not conflict in any way with any patent, license, trademark, or copyright of any third party. To the knowledge of Seller, there are no infringements of any proprietary rights owned by or licensed by or to Seller that could reasonably be expected to have, individually or in the aggregate, a Seller Material Adverse Effect. Seller has taken reasonable security measures to protect the confidentiality of its trade secrets. Except as set forth in Section 3.10 of the Seller Disclosure Schedule, all current and past employees or consultants of Seller, who, either alone or in concert with others, developed, invented, discovered, derived, programmed or designed such trade secrets, or who have or had access to information disclosing such trade secrets, have entered into confidentiality and non-disclosure agreements with Seller (the "Seller Trade Secret Agreements"). Any exception which has been taken to the Trade Secrets Agreements (for example an employee or consultant excluding a prior invention) is described in Section 3.10 of the Seller Disclosure Schedule, including the exception taken and the employee taking such exception. To the knowledge of Seller, neither Seller, nor its employees or its consultants have caused any of Seller's trade secrets to become part of the public knowledge or literature, nor has Seller, its employees or consultants permitted any such trade secrets to be used, divulged or appropriated for the benefit of persons to the material detriment of Seller.

Section 3.11 Tax Returns and Payments. Except as set forth in Section 3.11 of the Seller Disclosure Schedule, all tax returns and reports with respect to Seller required by law to be filed under the laws of any jurisdiction, domestic or foreign, have been duly and timely filed and all taxes, fees or other governmental charges of any nature which were required to have been paid have been paid or provided for. Seller has no knowledge of any unpaid taxes or any actual or threatened assessment of deficiency or additional tax or other governmental charge or a basis for such a claim against Seller. Seller has no knowledge of any tax audit of Seller by any taxing or other authority in connection with any of its fiscal years; Seller has no knowledge of any such audit currently pending or threatened, and Seller has no knowledge of any tax

liens on any of the properties of Seller.

Section 3.12 Certificate of Incorporation and Bylaws. Seller has heretofore furnished to Buyer and Acquisition Subsidiary a complete and correct copy of the certificate of incorporation and the bylaws, each as amended to the date hereof, of Seller. Such certificate of incorporation and bylaws are in full force and effect. Seller is not in violation of any of the provisions of its certificate of incorporation or bylaws.

Section 3.13 Title to Property.

(a) Seller has good and marketable title, or valid leasehold rights in the case of leased property, to all real property and all personal property purported to be owned or leased by it, free and clear of all material liens, security interests, claims, encumbrances and charges, excluding (i) immaterial liens for fees, taxes, levies, imposts, duties or governmental tax of any kind which are not yet delinquent or are being contested in good faith by appropriate proceedings which suspend the collection thereof, (ii) immaterial liens for mechanics, materialmen, laborers, employees, suppliers or other liens arising by operation of law for sums which are not yet delinquent or are being contested in good faith by appropriate proceedings, (iii) purchase money liens on office, computer and related equipment and supplies incurred in the ordinary course of business, and (iv) liens or defects in title or leasehold rights that, individually or in the aggregate, could not reasonably be expected to have a Seller Material Adverse Effect.

(b) Consummation of the Merger will not result in any breach of or constitute a default (or an event with which notice or lapse of time or both would constitute a default) under, or give to others any rights of termination or cancellation of, or require the consent of others under, any lease in which Seller is a lessee, except for breaches or defaults which, individually, or in the aggregate, could not reasonably be expected to have a Seller Material Adverse Effect.

#### Section 3.14 Employee Benefits and Contracts.

(a) Section 3.14 of the Seller Disclosure Schedule lists all employee benefit plans (as defined in Section 3(3) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA")) maintained by Seller. Each of such employee benefit plans complies in all material respects with applicable requirements of ERISA or the Code of 1986 and no "reportable event" or "prohibited transaction" (as such terms are defined in ERISA) has occurred with respect to any such plan, and no termination, if it has occurred or were to occur before the Effective Date, would present a risk of liability to any Governmental Entity or other persons that would have a Seller Material Adverse Effect.

(b) Seller has never maintained an employee benefit plan subject to Section 412 of the Code or Title IV of ERISA. Each employee benefit plan of Seller intended to be qualified under Section 401(a) of the Code has received a favorable determination letter from the Internal Revenue Service confirming such qualification. Seller has never had an obligation to contribute to a "multi-employer plan" as defined in Section 4001(a)(3) of ERISA. There are no unfunded obligations under any employee benefit plan of Seller providing benefits after termination of employment to any employee or former employee, including but not limited to retiree health coverage and deferred compensation, but excluding continuation of health coverage required to be continued under Section 4980(B) of the Code. Each employee benefit plan of Seller may be amended or terminated by Seller without the consent or approval of any other person. There is no employee benefit plan, stock option plan, stock appreciation right plan, restricted stock plan, stock purchase plan, or severance benefit plan of Seller, any of the benefits of which will be increased or the vesting of the benefits under which will be accelerated by the occurrence of any of the transactions contemplated by this Agreement or the benefits under which will be calculated on the basis of the transactions contemplated by this Agreement.

(c) Seller is not obligated to make any parachute payment, as defined in Section 280G(b)(2) of the Code, nor will any parachute payment be deemed to have occurred as a result of or arising out of any of the transactions contemplated by this Agreement. Seller has no contract, agreement, obligation or arrangement with any employee or other person, any of the benefits of which will be increased or the vesting of the benefits under which will be accelerated by any change of control of Seller or the occurrence of any of the transactions contemplated by this Agreement or the benefits under which will be calculated on the basis of the transactions contemplated by this Agreement.

#### Section 3.15 Employment; Labor Matters.

(a) Seller has delivered to Buyer true, complete and correct copies of all employment agreements and all consulting agreements to which Seller is a party.

(b) Except as set forth in Section 3.15 of the Seller Disclosure Schedule (i) Seller is not a party to any outstanding employment agreements or contracts with directors, officers, employees or consultants; (ii) Seller is not a party to any agreement, policy or practice that requires it to pay termination or severance pay to employees (other than as required by law); and (iii) Seller is not a party to any collective bargaining agreement or other labor union contract applicable to persons employed by Seller, nor does Seller know of any activities or proceedings of any labor union to organize any such employees.

Section 3.16 Brokers. No broker, finder or investment banker is entitled to any brokerage, finder's or other fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Seller.

Section 3.17 Environmental Laws. Except as could not reasonably be expected to have, individually or in the aggregate, a Seller Material Adverse Effect: (i) Seller is in compliance with all applicable Environmental Laws (as defined below); (ii) all past noncompliance, if any, of Seller with Environmental Laws or Environmental Permits (as defined below) has been resolved without any pending, ongoing or future obligation, cost or liability; and (iii) Seller has not released or transported a Hazardous Material (as defined below), in violation of any Environmental Law.

For purposes of this Agreement:

(a) "Environmental Law" shall mean any law and any enforceable judicial or administrative interpretation thereof, including any judicial or administrative order, consent decree or judgment, relating to pollution or protection of the environment or natural resources, including, without limitation, those relating to the use, handling, transportation, treatment, storage, disposal, release or discharge of Hazardous Material, as in effect as of the date hereof.

(b) "Environmental Permit" shall mean any permit, approval, identification number, license or other authorization required under or issued pursuant to any applicable Environmental Law.

(c) "Hazardous Material" shall mean any hazardous or toxic substance, material or waste which is or becomes regulated by any local government authority, any state or the United State Government.

Section 3.18 Insurance. Section 3.18 of the Seller Disclosure Schedule sets forth a true and complete list of all insurance policies in force at the date hereof, with respect to the assets, properties or operations of Seller. True and complete copies of all such insurance policies have been made available to Buyer and Acquisition Subsidiary by Seller. Such policies are in full force and effect.

Section 3.19 Contracts and Commitments.

(a) Except as disclosed in Section 3.10, 3.15 or 3.19 of the Seller Disclosure Schedule, Seller is not a party or subject to:

(i) any plan, contract or arrangement, written or oral, which requires aggregate payments by Seller in excess of \$50,000 per year or which provides for bonuses, pensions, deferred compensation, severance pay or benefits, retirement payments, profit-sharing, or the like;

(ii) any joint marketing, joint development or joint venture contract or arrangement or any other agreement which has involved or is expected to involve a sharing of profits with other persons;

(iii) any lease for real or personal property in which the amount of payments which Seller is required to make on an annual basis exceeds \$50,000;

(iv) any agreement, contract, mortgage, indenture, lease, instrument, license, franchise, permit, concession, arrangement, commitment or authorization which may be, by its terms, terminated or breached by reason of the execution of this Agreement, the Merger, or the consummation of the transactions contemplated hereby or thereby;

(v) except for trade indebtedness incurred in the ordinary course of business, any instrument evidencing or related in any way to indebtedness in excess of \$50,000 incurred in the acquisition of companies or other entities or indebtedness in excess of \$50,000 for borrowed money by way of direct loan, sale of debt securities, purchase money obligation, conditional sale, guarantee, indemnification or otherwise;

(vi) any contract containing covenants purporting to limit Seller's freedom to compete in any line of business or in any geographic area or with any third party,

(vii) any agreement, contract or commitment relating to capital expenditures and involving future obligations in excess of \$50,000; or

(viii) any other agreement, contract or commitment which is material to Seller taken as a whole.

(b) Except as disclosed in Section 3.19 of the Seller Disclosure Schedule, each agreement, contract, mortgage, indenture, plan, lease, instrument, permit, concession, franchise, arrangement, license and commitment listed in Section 3.19 of the Seller Disclosure Schedule is valid and binding on Seller and the other party(ies) thereto, is in full force and effect, and neither Seller, nor to the knowledge of Seller any other party thereto, has breached any material provision of, or is in material default under the terms of, any such agreement, contract, mortgage, indenture, plan, lease, instrument, permit, concession, franchise, arrangement, license or commitment.

(c) There is no agreement, judgment, injunction, order or decree binding upon Seller which has or could reasonably be expected to have the effect of prohibiting or materially impairing any current business practice of Seller, any acquisition of property by Seller or the conduct of business by Seller as currently conducted or as proposed to be conducted by Seller.

Section 3.20 Interests of Officers and Directors. To Seller's knowledge, except as set forth in Section 3.20 of the Seller Disclosure Schedule, no officer or director of Seller has had, either directly or indirectly, a material interest in: (i) any person or entity which purchases from or sells, licenses or furnishes to Seller any goods, property rights or services; (ii) except for the employment or consulting contracts listed in Section 3.15 of the Seller Disclosure Schedule, any contract or agreement to which Seller is a party or by which it may be bound or affected; or (iii) any property, real or personal, tangible or intangible, used in or pertaining to its business.

Section 3.21 Questionable Payments. Neither Seller nor to its knowledge any director, officer, agent or other employee of Seller has: (i) made any payments or provided services or other favors in the United States of America or in any foreign country in order to obtain preferential treatment or consideration by any Governmental Entity with respect to any aspect of the business of Seller; or (ii) made any political contributions which would not be lawful under the laws of the United States or the foreign country in which such payments were made. Neither Seller nor to its knowledge any director, officer, agent or other employee of Seller has been the subject of any inquiry or investigation by any Governmental Entity in connection with payments or benefits or other favors to or for the benefit of any governmental or armed services official, agent, representative or employee with respect to any aspect of the business of Seller or with respect to any political contribution.

Section 3.22 Certain Tax Matters. Neither Seller nor, to the knowledge of Seller, any of its affiliates has taken or agreed to take any action that could be expected to prevent the Merger from constituting a transaction qualifying under Section 368 of the Code. Seller is not aware of any agreement, plan or other circumstances that could reasonably be expected to prevent the Merger from so qualifying under Section 368 of the Code.

#### ARTICLE 4

##### REPRESENTATIONS AND WARRANTIES OF BUYER AND ACQUISITION SUBSIDIARY

Buyer and Acquisition Subsidiary represent and warrant to Seller as follows:

###### Section 4.1 Organization.

(a) Except as set forth in Section 4.1 of the disclosure schedule delivered to Seller on or before the date hereof (the "Buyer Disclosure Schedule"), each of Buyer and Acquisition Subsidiary (which is the only subsidiary of Buyer other than Seller) is a corporation duly organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation and has the requisite corporate power and authority and any necessary governmental authority to own, operate or lease the properties that it purports to own, operate or lease and to carry on its business as it is now being conducted, and, except as set forth in Section 4.1 of the Buyer Disclosure Schedule, is duly qualified as a foreign corporation to do business, and is in good standing, in each jurisdiction where the character of its properties owned, operated or leased or the nature of its activities makes such qualification necessary, except for such failure which, when taken together with all other such failures, would not have a Buyer Material Adverse Effect (as defined below in Section 4.1(b)).

(b) The term "Buyer Material Adverse Effect" means any individual material adverse effect, or adverse effects which in the aggregate (whether or not related and whether or not any individual effect is material) have a material adverse effect, on the business, operations, properties (including intangible properties), condition (financial or otherwise), assets or liabilities of Buyer and its subsidiaries taken as a whole or that could reasonably be expected to prevent or materially delay the consummation of the Merger.

(c) For purposes of this Article 4 and Article 5, Acute shall not be considered to be a subsidiary of Buyer.

###### Section 4.2 Capitalization.

(a) Capitalization. The authorized capital stock of Buyer consists of 20,000,000 shares of Buyer Common Stock, par value \$0.001 per share, and 5,000,000 shares of Preferred Stock, par value \$0.001 per share, of which 2,420,282 are designated Series B Convertible Preferred Stock (the "Series B Preferred Stock"). As of December 31, 1997, (i) 3,176,065 shares of Buyer Common Stock were issued and outstanding, (ii) 2,200,256 shares of Series B Preferred Stock were issued and outstanding and were convertible into 3,424,980 shares of Buyer Common Stock, (iii) 115,491 shares of Buyer Common Stock were held in the treasury of the Buyer, (iv) 253,535 shares of Buyer Common Stock were reserved for issuance upon exercise of outstanding options issued under the 1996 Stock Option Plan of Discovery Laboratories, Inc., a former Delaware corporation ("Old Discovery") and outside such plan and assumed by Buyer, (v) an aggregate of 116,162 shares of Buyer Common Stock were reserved for issuance under stock options granted pursuant to Buyer's 1993 and 1995 Stock Option Plans (the "Buyer Option Plans"), (vi) an aggregate of 2,297 shares of Buyer Common Stock were reserved for issuance under stock options granted by Buyer outside the Buyer Option Plans, (vii) an aggregate of 2,055,624 shares of Buyer Common Stock were reserved for issuance under outstanding warrants as more fully described in Section 4.2 of the Buyer Disclosure Schedule, (viii) 342,499 shares of Buyer Common Stock were reserved for issuance upon conversion of the 220,026 shares of Series B Preferred Stock issuable upon the exercise of outstanding warrants, and (ix) 173,333 shares of Buyer Common Stock were reserved for issuance upon exercise of Buyer's outstanding unit purchase option (including warrants issuable upon the exercise of such unit purchase option). Section 4.2 of the Buyer Disclosure Schedule sets forth a true and correct list as of December 31, 1997 of all holders of options to purchase shares of Buyer Common Stock, the number of such options outstanding as of such date and the exercise price per option. All of the outstanding shares of Buyer Common Stock have been duly authorized and validly issued and are fully paid and nonassessable and free of preemptive rights. Except as set forth in this Section 4.2 and Section 4.2 of the Buyer Disclosure Schedule, there are no other options, warrants or other rights, convertible debt, agreements, arrangements or commitments of any



character obligating Buyer or Acquisition Subsidiary to issue or sell any shares of capital stock of or other equity interests in Buyer or Acquisition Subsidiary other than Buyer's obligation to reset the conversion price applicable to the Series B Preferred Stock under the circumstances described in Buyer's Restated Certificate of Incorporation. Buyer is not obligated to redeem, repurchase or otherwise reacquire any of its capital stock or other securities.

(b) Except as set forth in Section 4.2 of the Buyer Disclosure Schedule, all of the outstanding shares of the capital stock of Acquisition Subsidiary are beneficially owned by Buyer, directly or indirectly, and all such shares have been duly authorized, validly issued and are fully paid and nonassessable and are owned by either Buyer or one of its subsidiaries free and clear of all liens, security interests, charges, claims or encumbrances of any nature whatsoever. There are no existing options, calls or commitments of any character relating to the issued or unissued capital stock or other securities of Acquisition Subsidiary. Except as set forth in Section 4.2 of the Buyer Disclosure Schedule, Buyer does not directly or indirectly own or have a right to acquire an equity interest in any corporation, partnership, joint venture or other business association or entity.

Section 4.3 Authorization; Validity of Agreement; Necessary Action. Each of Buyer and Acquisition Subsidiary has full corporate power and authority to execute and deliver this Agreement and all agreements to which Buyer and Acquisition Subsidiary is or will be a party that are exhibits to this Agreement, including the Employment Agreements (as defined in Section 6.2 herein), and to consummate the transactions contemplated hereby and thereby. The execution, delivery and performance by Buyer and Acquisition Subsidiary of this Agreement, and the consummation of the Merger and of the other transactions contemplated hereby and thereby, have been duly authorized by the Boards of Directors of Buyer and Acquisition Subsidiary, as the case may be, and no other corporate or stockholder action on the part of Buyer and Acquisition Subsidiary is necessary to authorize the execution and delivery by Buyer or Acquisition Subsidiary of this Agreement and the consummation of the transactions contemplated hereby and thereby (other than the approval of this Agreement and the Merger by the holders of a majority of the outstanding shares (on an as-converted basis) of Buyer capital stock entitled to vote with respect thereto). This Agreement has been duly executed and delivered by Buyer and Acquisition Subsidiary and assuming due and valid authorization, execution and delivery hereof by Seller, is a valid and binding obligation of Buyer and Acquisition Subsidiary, as the case may be, enforceable against Buyer and Acquisition Subsidiary in accordance with their respective terms.

Section 4.4 Consents and Approvals; No Violations. Except for the filings or the consents, authorizations or approvals under the agreements set forth in Section 4.4 of the Buyer Disclosure Schedule and the filings, permits, authorizations, consents and approvals as may be required under, and other applicable requirements of, the Exchange Act, the HSR Act, state securities or blue sky laws, the DGCL and the filing and recordation of a Certificate of Merger under the DGCL, neither the execution, delivery or performance of this Agreement by Buyer nor the consummation by Buyer of the transactions contemplated hereby nor compliance by Buyer with any of the provisions hereof will (i) conflict with or result in any breach of any provision of the certificate of incorporation or the bylaws of Buyer or Acquisition Subsidiary, (ii) require any filing with, or permit, authorization, consent or approval of, a Governmental Entity, on the part of Buyer or Acquisition Subsidiary, (iii) require the consent of any person under, result in a violation or breach of, or constitute (with or without due notice or lapse of time or both) a default (or give rise to any right of termination, amendment, cancellation or acceleration) under, any of the terms, conditions or provisions of any note, bond, mortgage, indenture, lease, license, contract, agreement or other instrument or obligation to which Buyer or Acquisition Subsidiary is a party or by which any of them or any of their properties or assets may be bound (the "Buyer Specified Agreements"), the lack of which consent, or which violation, breach or default, individually or in the aggregate, could reasonably be expected to have a Buyer Material Adverse Effect, or (iv) violate any order, writ, injunction, decree, statute, rule or regulation applicable to Buyer, Acquisition Subsidiary or any of their properties or assets.

#### Section 4.5 SEC Reports and Financial Statements.

(a) Buyer has timely filed with the Securities and Exchange Commission (the "SEC"), and has delivered to Seller, true and complete copies of, all forms, reports, schedules, statements and other documents required to be filed by it since January 1, 1996, under the Securities Act of 1933, as amended, or the Exchange Act (collectively, the "SEC Documents"). Except as set forth in Section 4.5 of the Buyer Disclosure Schedule, the SEC Documents (i) were prepared in accordance with the requirements of the Securities Act or the Exchange Act, as the case may be, including without limitation the applicable accounting requirements thereunder and the published rules and regulations of the SEC with respect thereto, (ii) when filed, did not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading, and (iii) taken as a whole, do not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading. Acquisition Subsidiary is not required to file any statements or reports with the SEC pursuant to Sections 13(a) or 15(d) of the Exchange Act.

(b) Except as set forth in Section 4.5 of the Buyer Disclosure Schedule, the consolidated financial statements of Buyer contained in the SEC Documents (the "Buyer Financial Statements"), have been prepared in accordance with United States generally accepted accounting principles ("GAAP") applied on a consistent basis during the periods involved (except as may be indicated in the notes thereto) and fairly present the financial position and the results of operations and cash flows (and changes in financial position, if any) of Buyer and Acquisition Subsidiary as of the respective dates and for the respective periods

thereof, except that the unaudited interim quarterly financial statements were or are subject to normal and recurring year-end adjustments which were or are not expected to be material in amount and did not or may not have included footnote disclosure that would otherwise be required by GAAP. Except as set forth in Section 4.5 of the Buyer Disclosure Schedule, Buyer is not aware of any facts or circumstances which would require Buyer to amend or restate any of the SEC Documents, including without limitation the financial information included therein.

Section 4.6 Absence of Certain Changes. Since December 31, 1997, except as contemplated by this Agreement or set forth in Section 4.6 of the Buyer Disclosure Schedule, there has not been:

(a) any Buyer Material Adverse Effect;

(b) any material damage, destruction or loss (whether or not covered by insurance) with respect to any of the material assets of Buyer or Acquisition Subsidiary;

(c) any issuance, redemption or acquisition of capital stock by Buyer or Acquisition Subsidiary or any declaration or payment of any dividend or other distribution in cash, stock or property with respect to capital stock;

(d) any stock split, reverse stock split, combination, reclassification or other similar action with respect to capital stock;

(e) any entry into any material commitment or transaction (including, without limitation, any borrowing or capital expenditure) other than in the ordinary course of business or as contemplated by this Agreement;

(f) any acquisition or disposition of rights (pursuant to license, sublicense or otherwise) under or with respect to any patent, copyright, trademark, tradename or other intellectual property right or registration thereof or application therefor;

(g) any mortgage, pledge, security interest or imposition of lien or other encumbrance on any material asset of Buyer or Acquisition Subsidiary; or

(h) any change by Buyer in accounting principles or methods except insofar as may have been required by a change in generally accepted accounting principles and disclosed in the SEC Documents.

Except as set forth in Section 4.6 of the Buyer Disclosure Schedule, since December 31, 1997, Buyer and its subsidiaries have conducted their business only in the ordinary course and in a manner consistent with past practice and have not made any material change in the conduct of the business or operations of Buyer and Acquisition Subsidiary taken as a whole. Except as set forth in Section 4.14(b) of the Buyer Disclosure Schedule, no person has or will have the right to receive any severance, bonus, other payment, increase or change in benefits or vesting of stock options, shares or other benefits as a result of any of the transactions contemplated by this Agreement.

Section 4.7 No Undisclosed Liabilities. Except as set forth in Section 4.7 of the Buyer Disclosure Schedule, and except as reflected in the Buyer Financial Statements contained in the SEC Documents, Buyer and Acquisition Subsidiary have no liabilities of any nature (whether accrued, absolute, contingent or otherwise), except those liabilities incurred in the ordinary course of business which could not, individually or in the aggregate, reasonably be expected to have a Buyer Material Adverse Effect.

Section 4.8 Litigation. Except as disclosed in the SEC Documents or in Section 4.8 of the Buyer Disclosure Schedule, there is no suit, claim, action, proceeding or investigation pending or, to the knowledge of Buyer, threatened against Buyer. Except as disclosed in the SEC Documents or in Section 4.8 of the Buyer Disclosure Schedule, neither Buyer nor Acquisition Subsidiary is subject to any outstanding order, writ, injunction or decree.

Section 4.9 No Default; Compliance with Applicable Laws. Except as disclosed in Section 4.9 of the Buyer Disclosure Schedule, the business of each of Buyer and Acquisition Subsidiary is not being conducted in default or violation of any term, condition or provision of (i) its certificate of incorporation or bylaws, (ii) any Buyer Specified Agreement or (iii) any federal, state, local or foreign statute, law, ordinance, rule, regulation, judgment, decree, order, concession, grant, franchise, permit or license or other governmental authorization or approval applicable to Buyer or Acquisition Subsidiary, excluding from the foregoing clauses (ii) and (iii), defaults or violations which could not, individually or in the aggregate, reasonably be expected to have a Buyer Material Adverse Effect. Except as disclosed in Section 4.9 of the Buyer Disclosure Schedule, as of the date of this Agreement, no investigation or review by any Governmental Entity or other entity with respect to Buyer or Acquisition Subsidiary is pending or, to the knowledge of Buyer, threatened, nor has any Governmental Entity or other entity indicated an intention to conduct the same. Each of Buyer and Acquisition Subsidiary has in effect all Federal, state, local and foreign governmental approvals, authorizations, certificates, filings, franchises, licenses, notices, permits and rights ("Buyer Permits") necessary for it to own, lease or operate its properties and assets and to carry on its business as now conducted, and there has occurred no default under any such Buyer Permit.

Section 4.10 Intellectual Property. Except as set forth in Section 4.10 of the Buyer Disclosure Schedule, or as could not reasonably be expected to have, individually or in the aggregate, a Buyer Material Adverse Effect, Buyer and its subsidiaries own or possess adequate licenses or other valid rights to use all patents, trademarks, trade names, copyrights, service marks, trade secrets, know-how and other proprietary rights and information used or held for use in connection with the business of Buyer and its subsidiaries as currently conducted, and Buyer is unaware of any assertion or claim challenging the validity of any of the foregoing. Section 4.10 of the Buyer Disclosure Schedule lists all material licenses, sublicenses and other agreements to which the Buyer or Acquisition Subsidiary is a party and pursuant to which (i) any third party is authorized to use any intellectual property right of the Buyer or Acquisition

Subsidiary and (ii) Buyer or its subsidiaries are authorized to use any intellectual property rights (other than pursuant to shrink-wrap licenses and other software licenses) of a third party, true and correct copies of which have been provided to Seller. Except as set forth in Section 4.10 of the Buyer Disclosure Schedule, the conduct of the business of Buyer and its subsidiaries as currently conducted does not conflict in any way with any patent, license or copyright of any third party. To the knowledge of Buyer, except as set forth in Section 4.10 of the Buyer Disclosure Schedule, there are no infringements of any proprietary rights owned by or licensed by or to Buyer or Acquisition Subsidiary that could reasonably be expected to have, individually or in the aggregate, a Buyer Material Adverse Effect. Buyer has taken reasonable security measures to protect the confidentiality of its trade secrets. All current and past employees or consultants of Buyer, who, either alone or in concert with others, developed, invented, discovered, derived, programmed or designed such trade secrets, or who have or had access to information disclosing such trade secrets, have entered into confidentiality and non-disclosure agreements with Buyer (the "Buyer Trade Secret Agreements"). Any exception which has been taken to the Buyer Trade Secrets Agreements (for example an employee or consultant excluding a prior invention) is described in Section 4.10 of the Buyer Disclosure Schedule, including the exception taken and the employee taking such exception. To the knowledge of Buyer, neither Buyer, nor its employees or its consultants have caused any of Buyer's trade

secrets to become part of the public knowledge or literature, nor has Buyer, its employees or consultants permitted any such trade secrets to be used, divulged or appropriated for the benefit of persons to the material detriment of Buyer.

Section 4.11 Tax Returns and Payments. All tax returns and reports with respect to Buyer or Acquisition Subsidiary required by law to be filed under the laws of any jurisdiction, domestic or foreign, have been duly and timely filed and all taxes, fees or other governmental charges of any nature which were required to have been paid have been paid or provided for. Buyer and Acquisition Subsidiary have no knowledge of any unpaid taxes or any actual or threatened assessment of deficiency or additional tax or other governmental charge or a basis for such a claim against Buyer or Acquisition Subsidiary. Buyer and Acquisition Subsidiary have no knowledge of any tax audit of Buyer or Acquisition Subsidiary by any taxing or other authority in connection with any of its fiscal years; Buyer and Acquisition Subsidiary have no knowledge of any such audit currently pending or threatened, and Buyer and Acquisition Subsidiary have no knowledge of any tax liens on any of the properties of Buyer or Acquisition Subsidiary.

Section 4.12 Certificate of Incorporation and Bylaws. Buyer and Acquisition Subsidiary have heretofore furnished to Seller a complete and correct copy of the certificate of incorporation and the bylaws, each as amended to the date hereof, of Buyer and Acquisition Subsidiary. Such certificate of incorporation and bylaws are in full force and effect. Neither Buyer nor Acquisition Subsidiary is in violation of any of the provisions of its certificate of incorporation.

Section 4.13 Title to Property.

(a) Except as disclosed in Section 4.13 to the Buyer Disclosure Schedule, Buyer and Acquisition Subsidiary has good and marketable title, or valid leasehold rights in the case of leased property, to all real property and all personal property purported to be owned or leased by them, free and clear of all material liens, security interests, claims, encumbrances and charges, excluding (i) immaterial liens for fees, taxes, levies, imposts, duties or governmental tax of any kind which are not yet delinquent or are being contested in good faith by appropriate proceedings which suspend the collection thereof, (ii) immaterial liens for mechanics, materialmen, laborers, employees, suppliers or other liens arising by operation of law for sums which are not yet delinquent or are being contested in good faith by appropriate proceedings, (iii) purchase money liens on office, computer and related equipment and supplies incurred in the ordinary course of business, and (iv) liens or defects in title or leasehold rights that, individually or in the aggregate, could not reasonably be expected to have a Buyer Material Adverse Effect.

(b) Except as set forth in Section 4.13(b) of the Buyer Disclosure Schedule, consummation of the Merger will not result in any breach of or constitute a default (or an event with which notice or lapse of time or both would constitute a default) under, or give to others any rights of termination or cancellation of, or require the consent of others under, any lease in which Buyer or Acquisition Subsidiary is a lessee, except for breaches or defaults which, individually or in the aggregate, could not reasonably be expected to have a Buyer Material Adverse Effect.

Section 4.14 Employee Benefits and Contracts.

(a) Section 4.14 of the Buyer Disclosure Schedule lists all employee benefit plans (as defined in Section 3(3) of the ERISA) maintained by Buyer and Acquisition Subsidiary. Each of such employee benefit plans complies in all material respects with applicable requirements of ERISA or the Internal Revenue Code of 1986, as amended (the "Code") and no "reportable event" or "prohibited transaction" (as such terms are defined in ERISA) has occurred with respect to any such plan, and no termination, if it has occurred or were to occur before the Effective Date, would present a risk of liability to any Governmental Entity or other persons that would have a Buyer Material Adverse Effect.

(b) Buyer and Acquisition Subsidiary has never maintained an employee benefit plan subject to Section 412 of the Code or Title IV of ERISA. Each employee benefit plan of Buyer or Acquisition Subsidiary intended to be qualified under Section 401(a) of the Code has received a favorable determination letter from the Internal Revenue Service confirming such qualification. Neither Buyer nor Acquisition Subsidiary has ever had an obligation to contribute to a "multi-employer plan" as defined in Section 4001(a)(3) of ERISA. There are no unfunded obligations under any employee benefit plan of Buyer or Acquisition Subsidiary providing benefits after termination of employment to any employee or former employee, including but not limited to retiree health coverage and deferred compensation, but excluding continuation of health coverage required to be continued under Section 4980(B)

of the Code. Each employee benefit plan of Buyer or Acquisition Subsidiary may be amended or terminated by Buyer or Acquisition Subsidiary without the consent or approval of any other person. There is no employee benefit plan, stock option plan, stock appreciation right plan, restricted stock plan, stock purchase plan, or severance benefit plan of Buyer or Acquisition Subsidiary, any of the benefits of which will be increased or the vesting of the benefits under which will be accelerated by the occurrence of any of the transactions contemplated by this Agreement or the benefits under which will be calculated on the basis of the transactions contemplated by this Agreement, except as set forth in Section 4.14(b) of the Buyer Disclosure Schedule.

(c) Neither Buyer nor Acquisition Subsidiary is obligated to make any parachute payment, as defined in Section 280G(b)(2) of the Code, nor will any parachute payment be deemed to have occurred as a result of or arising out of any of the transactions contemplated by this Agreement. Neither Buyer nor Acquisition Subsidiary has any contract, agreement, obligation or arrangement with any employee or other person, any of the benefits of which will be increased or the vesting of the benefits under which will be accelerated by any change of control of Buyer or Acquisition Subsidiary or the occurrence of any of the transactions contemplated by this Agreement or the

benefits under which will be calculated on the basis of the transactions contemplated by this Agreement except as set forth in Section 4.14(b) of the Buyer Disclosure Schedule.

#### Section 4.15 Employment; Labor Matters.

(a) Buyer has delivered to Seller true, complete and correct copies of all employment agreements and all consulting agreements to which Buyer or Acquisition Subsidiary is a party.

(b) Except as set forth in Section 4.15 of the Buyer Disclosure Schedule (i) neither Buyer nor Acquisition Subsidiary is a party to any outstanding employment agreements or contracts with directors, officers, employees or consultants; (ii) neither Buyer nor Acquisition Subsidiary is a party to any agreement, policy or practice that requires it to pay termination or severance pay to employees (other than as required by law); and (iii) neither Buyer nor Acquisition Subsidiary is a party to any collective bargaining agreement or other labor union contract applicable to persons employed by Buyer or Acquisition Subsidiary, nor does Buyer or Acquisition Subsidiary know of any activities or proceedings of any labor union to organize any such employees.

Section 4.16 Brokers. No broker, finder or investment banker is entitled to any brokerage, finder's or other fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by and on behalf of Buyer or Acquisition Subsidiary.

Section 4.17 Environmental Laws. Except as disclosed in Section 4.17 of the Buyer Disclosure Schedule or as could not reasonably be expected to have, individually or in the aggregate, a Buyer Material Adverse Effect: (i) Buyer and Acquisition Subsidiary is in compliance with all applicable Environmental Laws; (ii) all past noncompliance, if any, of Buyer or Acquisition Subsidiary with Environmental Laws or Environmental Permits has been resolved without any pending, ongoing or future obligation, cost or liability; and (iii) neither Buyer nor Acquisition Subsidiary has released or transported a Hazardous Material, in violation of any Environmental Law.

Section 4.18 Insurance. Section 4.18 of the Buyer Disclosure Schedule sets forth a true and complete list of all insurance policies in force at the date hereof, with respect to the assets, properties or operations of each of Buyer and Acquisition Subsidiary. True and complete copies of all such insurance policies have been made available to Seller by Buyer. Such policies will not be terminated as a result of the Merger, subject to payment of applicable premiums. Such policies also are in full force and effect.

#### Section 4.19 Contracts and Commitments.

(a) Except as disclosed in Section 4.10, 4.15 or 4.19 of the Buyer Disclosure Schedule, neither Buyer nor Acquisition Subsidiary is a party or subject to:

(i) any plan, contract or arrangement, written or oral, which requires aggregate payments by Buyer or Acquisition Subsidiary in excess of \$50,000 per year or which provides for bonuses, pensions, deferred compensation, severance pay or benefits, retirement payments, profit-sharing, or the like;

(ii) any joint marketing, joint development or joint venture contract or arrangement or any other agreement which has involved or is expected to involve a sharing of profits with other persons;

(iii) any lease for real or personal property in which the amount of payments which Buyer or Acquisition Subsidiary is required to make on an annual basis exceeds \$50,000;

(iv) any agreement, contract, mortgage, indenture, lease, instrument, license, franchise, permit, concession, arrangement, commitment or authorization which may be, by its terms, terminated or breached by reason of the execution of this Agreement, the Merger, or the consummation of the transactions contemplated hereby or thereby;

(v) except for trade indebtedness incurred in the ordinary course of business, any instrument evidencing or related in any way to indebtedness in excess of \$50,000 incurred in the acquisition of companies or other entities or indebtedness in excess of \$50,000 for borrowed money by way of direct loan, sale of debt securities, purchase money obligation, conditional sale, guarantee, indemnification or otherwise;

(vi) any contract containing covenants purporting to limit Buyer's



or Acquisition Subsidiary's freedom to compete in any line of business or in any geographic area or with any third party,

(vii) any agreement, contract or commitment relating to capital expenditures and involving future obligations in excess of \$50,000; or

(viii) any other agreement, contract or commitment which is material to Buyer and Acquisition Subsidiary taken as a whole.

(b) Except as disclosed in Section 4.19 of the Buyer Disclosure Schedule, each agreement, contract, mortgage, indenture, plan, lease, instrument, permit, concession, franchise, arrangement, license and commitment listed in Section 4.19 of the Buyer Disclosure Schedule is valid and binding on Buyer or Acquisition Subsidiary and the other party(ies) thereto, as applicable, and assuming due and valid authorization, execution and delivery by all counter parties, is in full force and effect, and neither Buyer, Acquisition Subsidiary, nor to the knowledge of Buyer any other party thereto, has breached any material provision of, or is in material default under the terms of, any such agreement, contract, mortgage, indenture, plan, lease, instrument, permit, concession, franchise, arrangement, license or commitment.

(c) There is no agreement, judgment, injunction, order or decree binding upon the Buyer or Acquisition Subsidiary which has or could reasonably be expected to have the effect of prohibiting or materially impairing any current business practice of Buyer or Acquisition Subsidiary, any acquisition of property by Buyer or Acquisition Subsidiary or the conduct of business by Buyer or Acquisition Subsidiary as currently conducted or as proposed to be conducted by Buyer or Acquisition Subsidiary.

Section 4.20 Interests of Officers and Directors. To Buyer's knowledge, except as set forth in Section 4.20 of the Buyer Disclosure Schedule, no officer or director of Buyer or Acquisition Subsidiary has had, either directly or indirectly, a material interest in: (i) any person or entity which purchases from or sells, licenses or furnishes to Buyer or Acquisition Subsidiary any goods, property rights or services; (ii) except for the contracts listed in Section 4.15 of the Buyer Disclosure Schedule, any contract or agreement to which Buyer or Acquisition Subsidiary is a party or by which it may be bound or affected; or (iii) any property, real or personal, tangible or intangible, used in or pertaining to its business or that of Acquisition Subsidiary.

Section 4.21 Questionable Payments. Neither Buyer nor Acquisition Subsidiary nor to its knowledge any director, officer, agent or other employee of Buyer or Acquisition Subsidiary has: (i) made any payments or provided services or other favors in the United States of America or in any foreign country in order to obtain preferential treatment or consideration by any Governmental Entity with respect to any aspect of the business of Buyer or Acquisition Subsidiary; or (ii) made any political contributions which would not be lawful under the laws of the United States or the foreign country in which such payments were made. Neither Buyer nor Acquisition Subsidiary nor to its knowledge any director, officer, agent or other employee of Buyer or Acquisition Subsidiary has been the subject of any inquiry or investigation by any Governmental Entity in connection with payments or benefits or other favors to or for the benefit of any governmental or armed services official, agent, representative or employee with respect to any aspect of the business of Buyer or Acquisition Subsidiary or with respect to any political contribution.

Section 4.22 Certain Tax Matters. Except as disclosed in Section 4.22 of the Buyer Disclosure Schedule, neither Buyer nor, to the knowledge of Buyer, any of its affiliates has taken or agreed to take any action that could be expected to prevent the Merger from constituting a transaction qualifying under Section 368 of the Code. Buyer is not aware of any agreement, plan or other circumstances that could reasonably be expected to prevent the Merger from so qualifying under Section 368 of the Code.

Section 4.23 No Prior Activities. Except for obligations or liabilities incurred in connection with its incorporation or organization or the negotiation and consummation of this Agreement and the transactions contemplated hereby (including any financing), Acquisition Subsidiary has not incurred any obligations or liabilities, and has not engaged in any business or activities of any type or kind whatsoever or entered into any agreements or arrangements with any person or entity. Acquisition Subsidiary is a wholly-owned subsidiary of Buyer.

## ARTICLE 5

### COVENANTS

Section 5.1 Interim Operations of Seller and Buyer. Seller and Buyer each hereby covenants and agrees with the other that, except (i) as expressly contemplated by this Agreement, (ii) as set forth in Section 5.1 of the Seller Disclosure Schedule, (iii) as set forth in Section 5.1 of the Buyer Disclosure Schedule or (iv) as agreed in writing by Seller and Buyer, after the execution and delivery of this Agreement and continuing until the earlier of the termination of this Agreement or the Effective Time:

(a) the business of such party and its subsidiaries shall be conducted only in the ordinary and usual course and, to the extent consistent therewith,

each party and its subsidiaries shall use its reasonable commercial efforts to preserve its business organization intact and maintain its existing relations with customers, suppliers, employees, creditors and business partners;

(b) each such party shall not, directly or indirectly, amend its or any of its subsidiaries' certificate of incorporation or bylaws or similar organizational documents;

(c) each such party shall not, and it shall not permit its subsidiaries to: (i)(A) declare, set aside or pay any dividend or other distribution payable in cash, stock or property with respect to such party's capital stock or that of its subsidiaries, or (B) redeem, purchase or otherwise acquire directly or indirectly any of such party's capital stock (or options, warrants, calls, commitments or rights of any kind to acquire any shares of capital stock) or that of its subsidiaries; (ii) issue, sell, pledge, dispose of or encumber any additional shares of, or securities convertible into or exchangeable for, or options, warrants, calls, commitments or rights of any kind to acquire, capital stock of any class of such party or its subsidiaries, other than Common Shares or Buyer Common Stock issuable upon the exercise of options and warrants outstanding on the date hereof and described in Section 3.2 of this Agreement or the Seller Disclosure Schedule or Section 4.2 of this

Agreement or the Buyer Disclosure Schedule; (iii) split, combine or reclassify the outstanding capital stock of such party or of its subsidiaries; or (iv) amend or otherwise modify the terms of any rights, warrants or options with respect to such party or of its subsidiary's capital stock;

(d) each such party shall not, and it shall not permit its subsidiaries to, acquire or agree to acquire, or dispose of or agree to dispose of, any material assets, either by purchase, merger, consolidation, sale of shares in any of its subsidiaries or otherwise, other than in the ordinary course of business;

(e) each such party shall not, and it shall not permit its subsidiaries to, transfer, lease, license, sell, mortgage, pledge or encumber any assets;

(f) except as contemplated by Section 4.14(b), neither such party nor its subsidiaries shall: (i) grant any increase in the compensation payable to any of its officers, directors or key employees; or (ii)(A) adopt any new, or (B) except as contemplated by Section 2.5, amend or otherwise increase, or accelerate the payment or vesting of the amounts payable or to become payable under any existing, bonus, incentive compensation, deferred compensation, severance, profit sharing, stock option, stock purchase, insurance, pension, retirement or other employee benefit plan, agreement or arrangement; or (iii) enter into or modify or amend any employment or severance agreement with or, except as required by applicable law, grant any severance or termination pay to any officer, director or employee of Seller or any of its subsidiaries; or (iv) enter into any collective bargaining agreement;

(g) neither such party nor any of its subsidiaries shall, without the other party's prior written consent, which consent shall not be unreasonably withheld, modify, amend or terminate any of its contracts or waive, release or assign any rights or claims;

(h) neither such party nor any of its subsidiaries shall: (i) incur or assume any indebtedness for money borrowed; (ii) modify any such indebtedness or other liability; (iii) assume, guarantee, endorse or otherwise become liable or responsible (whether directly, contingently or otherwise) for the obligations of any other person, other than immaterial amounts in the ordinary course of business consistent with past practice and other than for any subsidiary; (iv) make any loans, advances or capital contributions to, or investments in, any other person (other than to wholly-owned subsidiaries of such party); (v) change any of its methods of reporting income or deductions for federal income tax purposes from those employed in the preparation of the federal income tax returns for the year ended December 31, 1997, or (vi) enter into any material commitment or transaction except as contemplated by this Agreement;

(i) neither such party nor any of its subsidiaries shall change any of the accounting methods, practices or policies used by it unless required by a change in GAAP;

(j) such party shall not, and it shall not permit its subsidiaries to, make or agree to make any new capital expenditures in excess of \$10,000 in the aggregate;

(k) such party shall not, and it shall not permit its subsidiaries to, make any tax election (unless required by law) or settle or compromise any income tax liability; and

(l) neither party nor any of its subsidiaries will enter into an agreement, contract, commitment or arrangement to do any of the foregoing, or to authorize, recommend, propose or announce an intention to do any of the foregoing.

Section 5.2 Access; Confidentiality. Each of Seller and Buyer shall (and Buyer shall cause each of its subsidiaries to) (a) afford to the officers, employees, accountants, counsel and other representatives of Seller and Buyer, as the case may be, reasonable access to and the right to inspect and observe, during normal business hours during the period prior to the Effective Time, its personnel, accountants, representatives, properties, books, contracts, insurance policies, commitments and records, offices, plants and other facilities, (b) make available promptly to Seller or Buyer, as the case may be (i) a copy of each report, schedule, registration statement and other document filed or received by it during such period pursuant to the requirements of federal securities laws, if applicable and (ii) all other information concerning its business, properties and personnel as Seller or Buyer may reasonably request. Each party will treat any such information in accordance with the provisions of the letter agreement dated the date hereof between Seller and Buyer (the "Confidentiality Agreement"). No investigation conducted by Seller or Buyer shall impact any representation or warranty given by Seller to Buyer hereunder.

Section 5.3 Additional Agreements. Subject to the terms and conditions herein provided, each of the parties hereto shall use all reasonable commercial efforts to take, or cause to be taken, all action and to do, or cause to be done, all things necessary, proper or advisable under applicable laws and regulations, or to remove any injunctions or other impediments or delays, legal or otherwise, to consummate and make effective the Merger and the other transactions contemplated by this Agreement. Buyer also agrees to timely file all filings required to be made with the SEC with respect to such transactions.

Section 5.4 Consents and Approvals; HSR Act. Each of Seller, Buyer and Acquisition Subsidiary will take all reasonable actions necessary to comply promptly with all legal requirements which may be imposed on it with respect to this Agreement and the transactions contemplated hereby (which actions shall include, without limitation, furnishing all information required under the HSR Act and in connection with approvals of or filings with any other Governmental Entity) and will promptly cooperate with and furnish information to each other in connection with any such requirements imposed upon any of them or any of their subsidiaries in connection with this and the transactions contemplated hereby. Each of Seller, Buyer and Acquisition Subsidiary will, and will cause its subsidiaries to, take all reasonable actions necessary to obtain (and will cooperate with each other in obtaining) any consent, authorization, order or approval of, or any exemption by, any Governmental Entity or other public or private third party required to be obtained or made by Buyer, Acquisition Subsidiary, Seller or any of their subsidiaries in connection with the Merger or the taking of any action contemplated thereby or by this Agreement. Each party shall promptly inform the other party of any communication with, and any proposed understanding, undertaking, or agreement with, any Governmental Entity regarding any such filings or any such transaction.

Section 5.5 Exclusivity. From the date hereof until the earlier of termination of this Agreement or consummation of the Merger, neither Seller nor Buyer nor any of their officers, directors, employees, representatives (including any investment banker, attorney or accountant retained by them), agents or affiliates shall directly or indirectly encourage, solicit, initiate, facilitate or conduct discussions or negotiations with, provide any information to, or enter into any agreement with, any corporation, partnership, person or other entity or group concerning or expressing an interest in or proposing any merger, consolidation, reorganization, share exchange, business combination, liquidation, dissolution sale of all or other significant assets or securities or other similar transaction involving such party, except to the extent required by their fiduciary duties as determined by the Board of Directors of such party after discussion with their counsel.

Section 5.6 Publicity. So long as this Agreement is in effect, neither Seller, Buyer nor any of their respective affiliates shall issue or cause the publication of any press release or other public announcement with respect to the Merger, this Agreement or the other transactions between the parties contemplated hereby without the prior consultation of the other party, except as may be required by law or by any listing agreement with a national securities exchange or trading market.

Section 5.7 Notification of Certain Matters. Seller shall give prompt notice to Buyer and Acquisition Subsidiary, and Buyer and Acquisition Subsidiary shall give prompt notice to Seller, of (i) the occurrence or non-occurrence of any event the occurrence or non-occurrence of which would cause any representation or warranty made by such party or parties in this Agreement to be untrue or inaccurate in any material respect at or prior to the Effective Time and (ii) any failure of Seller, Buyer or Acquisition Subsidiary, as the case may be, to comply with or satisfy any covenant, condition or agreement to be complied with or satisfied by it hereunder; provided, however, that the delivery of any notice pursuant to this Section 5.7 shall not limit or otherwise affect the remedies available hereunder to the party receiving such notice. Seller also shall give prompt notice to Buyer, and Buyer or Acquisition Subsidiary shall give prompt notice to Seller, of:

(i) any notice or other communication from any person alleging that the consent of such person is or may be required in connection with the transactions contemplated by this Agreement (unless the requirement for such consent is set forth in Section 3.4 of the Seller Disclosure Schedule or Section 4.4 of the Buyer Disclosure Schedule);

(ii) any notice or other communication from any Governmental Entity in connection with the transactions contemplated by this Agreement;

(iii) any actions, suits, claims, investigations or proceedings commenced or, to its knowledge, threatened against, relating to or involving or otherwise affecting it or any of its subsidiaries or which relate to the consummation of the transactions contemplated by this Agreement; and

(iv) any occurrence of any event having, or which could reasonably be expected to have, a Seller Material Adverse Effect or Buyer Material Adverse Effect.

Section 5.8 Indemnification. Notwithstanding Section 8.7 hereof, Buyer agrees that all rights to indemnification existing in favor of directors, officers or employees of Seller as provided in Seller's certificate of

incorporation or bylaws, with respect to matters occurring through the Effective Time, shall survive the Merger and shall continue in full force and effect. If the Surviving Corporation or any of its successors or assigns (i) consolidates with or merges into any other person and shall not be the continuing or surviving corporation or entity of such consolidation or merger or (ii) transfers all or substantially all of its properties and assets to any person, then and in each such case, proper provision shall be made so that the successors and assigns of the Surviving Corporation assume the obligations set forth in this Section 5.8.

Section 5.9 Approval of Stockholders.

(a) Buyer shall, promptly after the date of this Agreement, take all actions necessary in accordance with the requirements of the bylaws of the National Association of Securities Dealers, Inc. ("NASD"), DGCL and its certificate of incorporation and bylaws to convene a meeting of Buyer's stockholders to act on this Agreement (the "Buyer Stockholders' Meeting") and Buyer shall consult with Seller in connection therewith.

(b) Unless Seller's Board of Directors in the good faith exercise of its fiduciary duties, after receiving advice from outside legal counsel, determines not to recommend, or to withdraw its recommendation that such matters be approved by Seller's stockholders, Seller shall, promptly after the date of this Agreement, take all actions necessary in accordance with DGCL and its certificate of incorporation and bylaws to obtain the unanimous written consent of Seller's stockholders to act on this Agreement, and Seller shall consult with Buyer in connection therewith.

Section 5.10 Buyer Proxy Statement. Unless the Board of Directors of Buyer in the good faith exercise of its fiduciary duties determines not to recommend the Merger and this Agreement to its stockholders (or to withdraw such recommendation), Buyer, acting through its Board of Directors, shall, in accordance with applicable law:

(i) after consultation with Seller and its legal counsel, diligently prepare and file with the SEC as soon as reasonably practicable after the date of this Agreement (but in no event later than 30 days after the date hereof), a preliminary proxy or information statement relating to the Merger and this Agreement and use commercially reasonable efforts (x) to obtain and furnish the information required to be included by the SEC in the Buyer Proxy Statement (as hereinafter defined) and, after consultation with Seller and its counsel, to respond promptly to any comments made by the SEC with respect to the preliminary proxy or information statement and cause a definitive proxy or information statement, including any amendment or supplement thereto (the "Buyer Proxy Statement") to be mailed to its stockholders, provided that no amendment or supplement to the Buyer Proxy Statement will be made by Buyer without consultation with Seller and its counsel and (y) to obtain the necessary approvals of the Merger and this Agreement by its stockholders;

(ii) prepare the preliminary proxy statement and prepare and revise the Buyer Proxy Statement so that at the date mailed to Buyer's stockholders and at the time of the meeting of Buyer's stockholders to be held in connection with the Merger, the Buyer Proxy Statement will (x) not contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order that the statements made therein, in light of the circumstances under which they are made, not misleading (except that Buyer shall not be responsible under this clause (ii) with respect to statements made therein based on information supplied by Seller expressly for inclusion in the Buyer Proxy Statement), and (y) comply in all material respects with the provisions of the Exchange Act and the rules and regulations thereunder; and

(iii) make at the Buyer's Stockholder's Meeting, and include in the Proxy Statement, the recommendation of the Board that stockholders of Buyer vote in favor of the approval of the Merger and the authorization and adoption of this Agreement.

Section 5.11 Seller Information Statement.

(a) Seller shall afford Buyer and its legal counsel a reasonable opportunity to review and comment on any solicitation materials, including solicitation of action by written consent, that Seller distributes to its stockholders in connection with the Merger, which shall be diligently prepared and distributed to Seller's stockholders as soon as reasonably practicable after the date of this Agreement and, at such date, such solicitation materials will not contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary in order that the statements made therein, in light of the circumstances under which they are made, not misleading (except that Seller shall not be responsible under this Section 5.11(a) with respect to statements made therein based on information supplied by Buyer expressly for inclusion in such solicitation materials). To the greatest extent practicable, information required to be disclosed in both the Buyer Proxy Statement and any such solicitation materials shall be disclosed in an identical manner.

(b) Seller shall furnish to Buyer, and revise, written information concerning itself expressly for inclusion in the Buyer Proxy Statement, including without limitation by reviewing and commenting (with respect to information concerning Seller) on drafts of the Buyer Proxy Statement and the preliminary proxy statement to be prepared pursuant to Section 5.10. Seller shall inform Buyer of any change regarding such information so that such Seller-furnished information will not, at both the date mailed to Buyer stockholders and at the time of the meeting of Buyer stockholders to be held in connection with the Merger, contain any untrue statement of a material fact or omit to state any material fact required to be stated in Seller furnished information or necessary in order to make the statements made in



Seller-furnished information, in light of the circumstances under which they are made, not misleading.

Section 5.12 Tax Treatment. Each party hereto shall use all reasonable efforts to cause the Merger to qualify and shall not take, and shall use all reasonable efforts to prevent any affiliate of such party from taking, any actions which could prevent the Merger from qualifying as a reorganization under the provisions of Section 368(a) of the Code.

Section 5.13 Form S-8. With respect to the Seller Option Plan, Buyer shall take all corporate action necessary or appropriate to, as soon as practicable after the Effective Time, file a registration statement on Form S-8 (or any successor or other appropriate form) with respect to the shares of Buyer Common Stock which will be subject to options outstanding under such plan as of the Closing to the extent such registration statement is required under applicable law in order for such shares of Buyer Common Stock to be sold without restriction, and Buyer shall use reasonable efforts to maintain the effectiveness of such registration statements (and maintain the current status of the prospectuses contained therein) for so long as such options under such plan remain outstanding.

Section 5.14 Reservation of Buyer Common Stock. Buyer shall reserve from its authorized but unissued shares of Buyer Common Stock that number of shares of Buyer Common Stock issuable upon exercise of the Seller Stock Options assumed by Buyer.

Section 5.15 Consolidation of Operations. Buyer and Seller shall cooperate with one another with a view toward consolidating the operations of Buyer and Seller at Seller's principal executive offices and eliminating duplicative staffing and overhead as soon as reasonably possible.

Section 5.16 Consolidation of Board of Directors. Buyer will utilize good faith efforts to decrease the membership of the Board of Directors of Buyer to a total of seven (7) members by the first anniversary of the date of this Agreement. It is agreed and understood that this Section 5.16 shall not require (i) Buyer to amend its organizational documents or (ii) Buyer's directors to take any actions inconsistent with their fiduciary duties.

Section 5.17 Incentive Bonus Payments. Buyer and Seller agree that the incentive bonus payments to be made to Robert J. Capetola, pursuant to Section 4.e. of the Capetola Employment Agreement attached as Exhibit A hereto, and to each of Harry G. Brittain, Cynthia Davis, Laurence B. Katz, Lisa Mastroianni, Christopher Schaber, Huei Tsai and Thomas Wiswell, pursuant to Section 4.d. of the employment agreements to be entered into with such individuals in the form of Exhibit B hereto, shall be determined for each of the above-named individuals by Buyer's Compensation Committee, shall be paid in either cash or equity as determined by such Compensation Committee, shall be in the following aggregate amounts and shall be paid upon the achievement of each of the following milestones (which are set forth in the aforementioned agreements): (a) \$150,000 upon the successful completion of Phase II studies for any compound under development in Discovery's portfolio (each a "Portfolio Compound"); (b) \$500,000 upon the successful completion of Phase II studies for any Portfolio Compound; and (c) \$1,000,000 upon receipt of marketing approval in the United States for any Portfolio Compound. The aforementioned bonuses shall be paid only once for each of the milestones.

## ARTICLE 6

### CONDITIONS

Section 6.1 Conditions to Each Party's Obligation to Effect the Merger. The respective obligation of each party to effect the Merger shall be subject to the satisfaction on or prior to the Effective Time of each of the following conditions, any and all of which may be waived in whole or in part by Seller, Buyer or Acquisition Subsidiary, as the case may be, to the extent permitted by applicable law:

(a) Stockholder Approval. This Agreement shall have been approved by the requisite vote of the stockholders of Seller, Buyer and Acquisition Subsidiary;

(b) Statutes. No statute, rule, order, decree or regulation shall have been enacted or promulgated by any Governmental Entity which prohibits the consummation of the Merger;

(c) Injunctions. There shall be no order or injunction of a court or other governmental authority of competent jurisdiction in effect precluding, restraining, enjoining or prohibiting consummation of the Merger;

(d) Tax Opinions. Buyer shall have received from Roberts, Sheridan & Kotel, P.C., counsel to Buyer, a written opinion dated as of the Closing Date to the effect that the Merger, when effected in accordance with this Agreement, will qualify as a reorganization under Section 368(a) of the Code; Seller shall have received from Brobeck, Phleger & Harrison LLP, counsel to Seller, a written opinion dated as of the Closing Date to the effect that the Merger, when effected in accordance with this Agreement, will qualify as a reorganization under Section 368(a) of the Code;

(e) Capetola Employment Agreement. Robert J. Capetola shall have entered into an employment agreement with Buyer, in the form attached as Exhibit A hereto;

(f) Key Executive Employment Agreements. Buyer and each of Harry G. Brittain, Cynthia Davis, Laurence B. Katz, Lisa Mastroianni, Christopher Schaber, Huei Tsai and Thomas Wiswell shall have entered into employment agreements as mutually agreed to by Buyer and Seller, substantially in the form attached as Exhibit B hereto (the "Key Executive Employment Agreements");

(g) Exchange Agreement. Buyer shall have entered into the Exchange

(h) Board of Directors. On the Effective Date, the Board of Directors of Buyer shall consist of Robert J. Capetola, Steve Kanzer, Max Link, Herbert McDade, David Naveh, Milton Packer, Richard Power, Mark Rogers, Marvin Rosenthale, and Richard Sperber.

(i) No Litigation. After the date hereof, there shall not be threatened, or instituted and continuing, any action, suit or proceeding against Seller, Buyer or Acquisition Subsidiary, by any Governmental Entity or any other person directly or indirectly relating to the Merger or any other transactions contemplated by this Agreement which individually or in the aggregate could reasonably be expected to have a Seller Material Adverse Effect or Buyer Material Adverse Effect.

Section 6.2 Additional Conditions to Obligations of Seller. The obligation of Seller to effect the Merger is also subject to the fulfillment of the following conditions:

(a) Representations and Warranties. The representations and warranties of Buyer and Acquisition Subsidiary contained in this Agreement shall be true and correct on the date hereof and shall also be true and correct on and as of the Effective Time, with the same force and effect as if made on and as of the Effective Time, unless the failure of such representations and warranties to be true and correct could not reasonably be expected to cause, individually or in the aggregate, a Buyer Material Adverse Effect (as applied to such dates);

(b) Agreements, Conditions and Covenants. Buyer and Acquisition Subsidiary shall have performed or complied in all material respects with all agreements, conditions and covenants required by this Agreement to be performed or complied with by them on or before the Effective Time;

(c) Certificate of Chairman of the Board. Seller shall have received a certificate of the Chairman of the Board of Directors of Buyer to the effect that each of the conditions specified in clauses (a) and (b) of this Section 6.2 have been satisfied;

(d) Stock Option Agreements. In addition to the Stock Options assumed by Buyer under Section 2.4, Buyer shall have granted stock options pursuant to Buyer Stock Option Plan in the forms of option agreements attached hereto as Exhibit C, Exhibit D and Exhibit E, to certain of Seller's employees as set forth on Schedule 6.2(d), for an aggregate of 338,500, 175,000 and 160,000 shares of Common Stock, respectively.

(e) Opinion. Seller shall have received an opinion dated as of the Closing Date from Roberts, Sheridan & Kotel P.C., counsel to Buyer and Acquisition Subsidiary, covering the matters set forth in Schedule 6.2(e).

(f) Registration Rights Agreement. Buyer shall have entered into a Registration Rights Agreement with JJDC and The Scripps Research Institute, substantially in the form attached hereto as Exhibit F.

Section 6.3 Additional Conditions to Obligations of Buyer and Acquisition Subsidiary. The obligations of Buyer and Acquisition Subsidiary to effect the Merger are also subject to the following conditions:

(a) Representations and Warranties. The representations and warranties of Seller contained in this Agreement shall be true and correct on the date hereof and shall also be true and correct on and as of the Effective Time, with the same force and effect as if made on and as of the Effective Time, unless the failure of such representations and warranties to be true and correct as of such dates could not reasonably be expected to cause, individually or in the aggregate, a Seller Material Adverse Effect (as applied to such dates);

(b) Agreements, Conditions and Covenants. Seller shall have performed or complied in all material respects with all agreements, conditions and covenants required by this Agreement to be performed or complied with by it on or before the Effective Time;

(c) Officer's Certificate. Buyer shall have received a certificate of the Chief Executive Officer of Seller to the effect that each of the conditions specified in clauses (a) and (b) of this Section 6.3. have been satisfied.

(d) Investment Agreement. Each holder of Common Shares shall have executed and delivered to Buyer the form of Investment Agreement attached as Exhibit G hereto.

(e) Opinion. Buyer shall have received an opinion dated as of the Closing Date from Brobeck, Phleger & Harrison LLP, counsel to Seller, covering the matters set forth in Schedule 6.3(e).

(f) Dissenting Common Shares. The aggregate number of Common Shares held by Dissenting Stockholders shall not be equal to or exceed five percent (5%) of the outstanding Common Shares immediately prior to the Effective Time.

(g) Contractual Lock-up Agreements. Each common stockholder and optionholder of Seller shall have entered into an agreement with Buyer substantially in the form of Exhibit H attached hereto.

(h) Buyer Stock Option Plan. The 1998 stock option plan of Buyer (the "1998 Stock Option Plan") in the form attached as Exhibit I hereto, shall have been approved by the requisite vote of the stockholders of Buyer.

(i) Termination Agreement. Seller shall enter into a letter agreement terminating the Co-Sale Agreement dated as of October 28, 1996 by and between Seller and the stockholders listed on Schedule A thereto.

## ARTICLE 7

### TERMINATION

Section 7.1 Termination. This Agreement may be terminated at any time prior to the Effective Time, whether before or after approval of the terms of this Agreement by the stockholders of Buyer or Seller:

(a) by mutual written consent of the Boards of Directors of Buyer and Seller;

(b) by either Buyer or Seller if any Governmental Entity shall have issued an order, decree or ruling or taken any other action permanently enjoining, restraining or otherwise prohibiting consummation of the Merger and such order, decree or ruling or other action shall have become final and nonappealable;

(c) by either Buyer or Seller, if the Merger shall not have been consummated by [July 15], 1998; provided, however, that the right to terminate this Agreement pursuant to this Section 7.1(c) shall not be available to any party whose failure (or the failure of the affiliates of which) to perform any of its obligations under this Agreement has been the cause of, or resulted in, the failure of the Merger to occur on or before such date; provided, further, that for this purpose, Buyer and Seller shall not be deemed to be affiliates of each other; directors, officers and employees of Seller shall be deemed to act only on behalf of such Seller; and directors, officers and employees of Buyer or Acquisition Subsidiary shall be deemed to act only on behalf of Buyer and/or Acquisition Subsidiary; and provided further that an individual holding positions on the boards of both Seller, on the one hand, and Buyer or Acquisition Subsidiary, on the other hand, shall be deemed to act only on behalf of Buyer and/or Acquisition Subsidiary unless such interpretation would be manifestly unreasonable;

(d) by Buyer or Acquisition Subsidiary, in the event of a breach by Seller of any representation, warranty, covenant or other agreement contained in this Agreement which cannot be or has not been cured within thirty (30) days after the giving of written notice to Seller and which, individually or in the aggregate, has had or could reasonably be expected to have, a Seller Material Adverse Effect; or

(e) by Seller, in the event of a breach by Buyer or Acquisition Subsidiary of any of their respective representations, warranties, covenants or other agreements contained in this Agreement, which cannot be or has not been cured within thirty (30) days after the giving of written notice to Buyer or Acquisition Subsidiary, and which, individually or in the aggregate, has had or could reasonably be expected to have, a Buyer Material Adverse Effect.

Section 7.2 Effect of Termination. In the event of a termination of this Agreement by either Seller or Buyer as provided in Section 7.1, this Agreement shall forthwith become void and there shall be no liability or obligation on the part of Buyer, Acquisition Subsidiary or Seller or their respective officers or directors, except with respect to Sections 3.16, 4.16, 5.2, this Section 7.2 and Article 8; provided, however, that nothing herein shall relieve any party of liability for any breach this Agreement.

## ARTICLE 8

### MISCELLANEOUS

Section 8.1 Fees and Expenses. All fees and expenses incurred in connection with the Merger, this Agreement and the transactions contemplated by this Agreement shall be paid by the party incurring such fees or expenses, whether or not the Merger is consummated.

Section 8.2 Amendment and Modification. Subject to applicable law, this Agreement may be amended, modified and supplemented in any and all respects, whether before or after any vote of the stockholders of Seller or Buyer contemplated hereby, by written agreement of the parties hereto, at any time prior to the Closing Date with respect to any of the terms contained herein; provided, however, that after the approval of this Agreement by the stockholders of Seller or Buyer, no such amendment, modification or supplement shall reduce the amount or change the form of the consideration to be received by Seller stockholders in the Merger.

Section 8.3 Nonsurvival of Representations and Warranties. None of the representations and warranties in this Agreement or in any schedule, instrument or other document delivered pursuant to this Agreement shall survive the Effective Time.

Section 8.4 Notices. All notices and other communications hereunder shall be in writing and shall be deemed given upon receipt, and shall be given to the parties at the following addresses (or at such other address for a party as shall be specified by like notice):

(a) if to Buyer or Acquisition Subsidiary, to:

Discovery Laboratories, Inc.  
509 Madison Avenue  
Suite 1406  
New York, NY 10022  
Telephone: (212) 223-9504  
Facsimile: (212) 688-7978

Attention: Steve H. Kanzer, Esq.

with copies to:

Roberts, Sheridan & Kotel, P.C.  
Tower Forty-Nine  
12 East 49th Street  
New York, NY 10017  
Telephone: (212) 299-8600  
Facsimile: (212) 299-8686

Attention: Kenneth G. Alberstadt, Esq.

(b) if to Seller, to:

Acute Therapeutics, Inc.  
3359 Durham Road  
Doylestown, PA 18901  
Telephone: (215) 794-3064  
Facsimile: (215) 794-3239

Attention: Robert J. Capetola, Ph. D.

with copies to:

Brobeck, Phleger & Harrison LLP  
1633 Broadway  
47th Floor  
New York, NY 10019  
Telephone: (212) 581-1600  
Facsimile: (212) 586-7878

Attention: Ellen B. Corenswet, Esq.

Section 8.5 Interpretation. When a reference is made in this Agreement to Sections, such reference shall be to a Section of this Agreement unless otherwise indicated. Whenever the words "include", "includes" or "including" are used in this Agreement they shall be deemed to be followed by the words "without limitation". As used in this Agreement, the term "affiliate(s)" shall have the meaning set forth in Rule 12b-2 of the Exchange Act. As used in this Agreement, a "subsidiary" of any entity shall mean all corporations or other entities in which such entity owns a majority of the issued and outstanding capital stock or equity or similar interests.

Section 8.6 Counterparts. This Agreement may be executed in two or more counterparts, all of which shall be considered one and the same agreement and shall become effective when one or more counterparts have been signed by each of the parties and delivered to the other parties.

Section 8.7 Entire Agreement; No Third Party Beneficiaries; Rights of Ownership. This Agreement and the Confidentiality Agreement (including the documents and the instruments referred to herein and therein): (a) constitute the entire agreement and supersede all prior agreements and understandings, both written and oral, among the parties with respect to the subject matter hereof, and (b) other than the provisions of Section 5.8 hereof, nothing expressed or implied in this Agreement is intended or will be construed to confer upon or give to any person, firm or corporation other than the parties hereto any rights or remedies under or by reason of this Agreement or any transaction contemplated hereby.

Section 8.8 Severability. If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction or other authority to be invalid, void, unenforceable or against its regulatory policy, the remainder of the terms, provisions,



covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated.

Section 8.9 Governing Law. This Agreement and the legal relations between the parties hereto will be governed by and construed in accordance with the laws of the State of Delaware, without giving effect to the choice of law principles thereof.

Section 8.10 Assignment. Neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by any of the parties hereto (whether by operation of law or otherwise) without the prior written consent of the other parties, except that Acquisition Subsidiary may assign, in its sole discretion, any or all of its rights, interests and obligations hereunder to Buyer or to any direct or indirect wholly owned subsidiary of Buyer. Subject to the preceding sentence, this Agreement will be binding upon, inure to the benefit of and be enforceable by the parties and their respective successors and assigns.

IN WITNESS WHEREOF, Buyer, Acquisition Subsidiary and Seller have caused this Agreement to be signed by their respective officers thereunto duly authorized as of the date first written above.

Buyer

By: /s/ James S. Kuo  
-----  
Name: James S. Kuo, M.D.  
Title: Chief Executive Officer

Acquisition Subsidiary

By: /s/ James S. Kuo  
-----  
Name: James S. Kuo, M.D.  
Title: President

Seller

By: /s/ Robert J. Capetola  
-----  
Name: Robert J. Capetola, Ph.D.  
Title: President and Chief Executive Officer

## FORM OF REGISTRATION RIGHTS AGREEMENT

THIS REGISTRATION RIGHTS AGREEMENT is made as of the \_\_\_ day of \_\_\_\_\_, 1998, by and among DISCOVERY LABORATORIES, INC., a Delaware corporation, (the "Company"), JOHNSON & JOHNSON DEVELOPMENT CORPORATION, a New Jersey Corporation ("J&J") and THE SCRIPPS RESEARCH INSTITUTE, a California not-for-profit organization ("Scripps") (J&J and Scripps are herein collectively referred to as the "Stockholders").

## RECITALS

WHEREAS, Acute Therapeutics, Inc. ("ATI") and Scripps are parties to the Scripps Stock Purchase Agreement dated as of October 28, 1996 (the "Scripps Agreement"), pursuant to which Scripps acquired 40,000 shares of common stock, \$0.001 par value per share of ATI (the "ATI Common Stock");

WHEREAS, J&J, its affiliate, Ortho Pharmaceutical Corporation and ATI are parties to the Inventory Transfer/Stock Purchase Agreement dated as of October 28, 1996 (the "Inventory Transfer Agreement"), pursuant to which ATI issued to J&J 2,200 shares of its Non-Voting Series B Preferred Stock, \$0.001 par value per share (the "ATI Series B Preferred Stock") and 40,000 shares of ATI Common Stock;

WHEREAS, ATI, Scripps and J&J are parties to a Registration Rights Agreement dated as of October 28, 1996 (the "ATI Registration Rights Agreement") pursuant to which Scripps and J&J were granted certain registration rights;

WHEREAS, the Company and ATI are parties to an agreement dated March \_\_, 1998, whereby a newly-formed subsidiary of the Company will merge with and into ATI and ATI will become a wholly-owned subsidiary of the Company (the "Merger Agreement");

WHEREAS, pursuant to the Merger Agreement, each of the issued and outstanding shares of ATI Common Stock shall be automatically converted into 3.91 shares of Common Stock of the Company, \$0.001 par value per share ("the Common Stock");

WHEREAS, the Company and J&J are parties to the Stock Exchange Agreement of even date herewith pursuant to which J&J will exchange its ATI Series B Preferred Stock for 2,039 shares of Series C Preferred Stock, \$0.001 par value per share, of the Company ("Series C Preferred Stock") and pursuant to which the Company will issue J&J shares of Common Stock (the "Dividend Shares") in lieu of the accrued but unpaid dividend accrued through the date of the Merger on its shares of ATI Series B Preferred Stock (the "Stock Exchange Agreement");

WHEREAS, the Stockholders and the Company hereby agree that this Registration Rights Agreement (the "Agreement") shall govern the rights of the Stockholders to cause the Company to register the shares of Common Stock held by the Stockholders;

NOW, THEREFORE, THE PARTIES HEREBY AGREE AS FOLLOWS:

1. Registration Rights. The Company covenants and agrees as follows:

1.1 Definitions. For purposes of this Section 1:

(a) The term "Act" means the Securities Act of 1933, as amended.

(b) The term "Holder" means any person owning or having the right to acquire Registrable Securities or any assignee thereof in accordance with Section 1.8 hereof.

(c) The term "1934 Act" shall mean the Securities Exchange Act of 1934, as amended.

(d) The term "register", "registered," and "registration" refer to a registration effected by preparing and filing a registration statement or similar document in compliance with the Act, and the declaration or ordering of effectiveness of such registration statement or document.

(e) The term "Registrable Securities" means (i) the Common Stock issued by the Company pursuant to the Merger Agreement in exchange for the shares of ATI Common Stock originally issued to Scripps pursuant to the Scripps Purchase Agreement, (ii) the Common Stock issued by the Company pursuant to the Merger Agreement in exchange for the shares of ATI Common Stock originally issued to J&J pursuant to the Inventory Transfer Agreement, (iii) any Common

Stock issued upon conversion or redemption of the Series C Preferred Stock, (iv) the Dividend Shares and (v) any Common Stock of the Company issued as (or issuable upon the conversion or exercise of any warrant, right or other security which is issued as) a dividend or other distribution with respect to, or

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in exchange for or in replacement of the shares referenced in (i)-(iv) above, that cannot be publicly resold by the holder thereof without registration under the Act or sold in a single transaction exempt from the registration and prospectus delivery requirement of the Act pursuant to Rule 144 thereunder, it being understood, for the purposes of this Agreement, that Registrable Securities shall cease to be Registrable Securities when (1) a registration statement covering such Registrable Securities has been declared effective and they have been disposed of pursuant to such effective registration statement, (2) they are transferred on the open market pursuant to any available exemption under the Act, (3) they have been otherwise transferred and the Company has delivered new certificates or other evidences of ownership for them not subject to any stop transfer order or other restriction on transfer and not bearing any legend restricting transfer in the absence of an effective registration or an exemption from the registration requirements of the Act, (4) they have been sold, assigned, pledged, hypothecated or otherwise disposed of by the Holder in a transaction in which the Holder's rights under this Agreement are not assigned or assignable, or (5) the rights of the Holder under Section 1.2 have terminated pursuant to Section 1.9.

(f) The number of shares of "Registrable Securities then outstanding" shall be determined by the number of shares of Common Stock outstanding which are Registrable Securities.

(g) The term "SEC" shall mean the Securities and Exchange Commission.

#### 1.2 Company Registration.

(a) If (but without any obligation to do so) the Company proposes to register (including for this purpose a registration effected by the Company for stockholders other than the Holders) any of its stock or other securities under the Act in connection with the public offering of such securities solely for cash (other than a registration relating solely to the sale of securities to participants in a Company stock plan, a registration on any form which does not include substantially the same information as would be required to be included in a registration statement covering the sale of the Registrable Securities or a registration in which the only Common Stock being registered is Common Stock issuable upon conversion of debt securities which are also being registered), the Company shall, at such time, promptly give each Holder written notice of such registration. Upon the written request of each Holder given within twenty (20) days after mailing of such notice by the Company in accordance with Section 2.5, the Company shall cause to be registered under the Act all of the Registrable Securities that each such Holder has requested to be registered.

(b) Notwithstanding any other provision of this Section 1.2, if the managing underwriter of an underwritten distribution advises in writing the Company and the Holders of the Registrable Securities requesting participation in such registration that in its good faith judgment the number of shares of Registrable Securities and the other securities requested to be registered under this Section 1.2 exceeds the number of shares of Registrable Securities and other securities which can be sold in such offering, then (i) the number of shares of Registrable Securities and other securities so requested to be included in the offering shall be reduced to that number of shares which in the good faith judgment of the managing underwriter can be sold in such offering (except for shares to be issued by the Company, which shall have priority over the Registrable Securities), and (ii) such reduced number of shares shall be allocated among all participating Holders of Registrable Securities and holders of other securities in proportion, as nearly as practicable, to the respective number of shares of Registrable Securities and other securities held by such Holders at the time of filing the registration statement; provided, however, that a minimum of thirty percent (30%) of the shares to be underwritten shall be allocated, on a pro rata basis, to the Holders requesting inclusion in such offering (the "selling stockholders"). For purposes of clause (ii) above concerning apportionment, for any selling stockholder which is a holder of Registrable Securities and which is a partnership or corporation, the affiliates (as defined in the rules and regulations promulgated under the Act), partners, retired partners and stockholders of such holder, or the estates and family members of any such partners and retired partners and any trusts for the benefit of any of the foregoing persons shall be deemed to be a single "selling stockholder", and any pro-rata reduction with respect to such "selling stockholder" shall be based upon the aggregate amount of shares carrying

registration rights owned by all entities and individuals included in such "selling stockholder", as defined in this sentence.

1.3 Obligations of the Company. Whenever required under this Section 1 to effect the registration of any Registrable Securities, the Company shall, as expeditiously as reasonably possible:

(a) Prepare and file with the SEC a registration statement with respect to such Registrable Securities and use its best efforts to cause such registration statement to become effective, and, upon the request of the Holders of a majority of the Registrable Securities registered thereunder, keep such registration statement effective for a period of up to one hundred twenty (120) days or until the distribution contemplated in the Registration Statement has been completed; provided, however, that (i) such 120-day period shall be extended for a period of time equal to the period the Holder refrains from selling any securities included in such registration at the request of an underwriter of Common Stock (or other securities) of the Company; and (ii) in the case of any registration of Registrable Securities on Form S-3 which are intended to be offered on a continuous or delayed basis, such 120-day period shall be extended, if necessary, to keep the registration statement effective until all such Registrable Securities are sold, provided that Rule 415, or any successor rule under the Act, permits an offering on a continuous or delayed basis, and provided further that applicable rules under the Act governing the obligation to file a post-effective amendment permit, in lieu of filing a post-effective amendment which (I) includes any prospectus required by Section 10(a)(3) of the Act or (II) reflects facts or events representing a material or fundamental change in the information set forth in the registration statement, the incorporation by reference of information required to be included in (I) and (II) above to be contained in periodic reports filed pursuant to Section 13 or 15(d) of the 1934 Act in the registration statement.

(b) Prepare and file with the SEC such amendments and supplements to such registration statement and the prospectus used in connection with such registration statement as may be necessary to comply with the provisions of the Act with respect to the disposition of all securities covered by such registration statement.

(c) Furnish to the Holders such numbers of copies of a prospectus, including a preliminary prospectus, in conformity with the requirements of the Act, and such other documents as they may reasonably request in order to facilitate the disposition of Registrable Securities owned by them.

(d) Use its best efforts to register and qualify the securities covered by such registration statement under such other securities or Blue Sky laws of such jurisdictions as shall be reasonably requested by the Holders; provided that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business or to file a general consent to service of process in any such states or jurisdictions, unless the Company is already subject to service in such jurisdiction and except as may be required by the Act.

(e) In the event of any underwritten public offering, enter into and perform its obligations under an underwriting agreement, in usual and customary form, with the managing underwriter of such offering. Each Holder participating in such underwriting shall also enter into and perform its obligations under such an agreement.

(f) Cause all such Registrable Securities registered pursuant hereunder to be listed on each securities exchange on which similar securities issued by the Company are then listed.

(g) Provide a transfer agent and registrar for all Registrable Securities registered pursuant hereunder and a CUSIP number for all such Registrable Securities, in each case not later than the effective date of such registration.

(h) Notify the participating Holders at any time when a prospectus relating to any Registrable Securities covered by such registration statement is required to be delivered under the Act, of the happening of any event as a result of which the prospectus included in such registration statement, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances then existing and promptly file such amendments and supplements as may be necessary so that, as thereafter delivered to such Holders of such Registrable Securities, such prospectus shall not include an untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein not misleading in light of the circumstances then existing and use its best efforts to cause each such amendment and supplement to become effective.

(i) Furnish on the closing date of an underwritten public offering (i) an opinion, dated such date, of the counsel representing the Company, for purposes of such registration, in form and substance as is customarily given by company counsel to the underwriters in an underwritten public offering, addressed to the underwriters, and (ii) a letter dated such date, from the independent certified public accountants of the Company, in form and substance as is customarily given by independent certified public accountants to underwriters in an underwritten public offering, addressed to the underwriters.

1.4 Furnish Information. It shall be a condition precedent to the obligations of the Company to take any action pursuant to this Section 1 with respect to the Registrable Securities of any selling Holder that such Holder shall furnish to the Company such information regarding itself, the Registrable Securities held by it, and the intended method of disposition of such securities as shall be required to effect the registration of such Holder's Registrable Securities.

1.5 Expenses of Company Registration. The Company shall bear and pay all expenses incurred in connection with any registration, filing or qualification of Registrable Securities with respect to the registrations pursuant to Section 1.2 for each Holder (which right may be assigned as provided in Section 1.8), including (without limitation) all federal and state registration, filing, qualification fees, printers and accounting fees relating or apportionable thereto and reasonable fees and disbursements of one counsel for the participating Holders together, but excluding underwriting discounts and commissions relating to Registrable Securities.

1.6 Delay of Registration. No Holder shall have any right to obtain or seek an injunction restraining or otherwise delaying any such registration as the result of any controversy that might arise with respect to the interpretation or implementation of this Section 1.

1.7 Indemnification. In the event any Registrable Securities are included in a registration statement under this Section 1:

(a) To the extent permitted by law, the Company will indemnify and hold harmless each Holder, any underwriter (as defined in the Act) for such Holder and each person, if any, who controls such Holder or underwriter within the meaning of the Act or the 1934 Act, and each officer, director, employee and agent thereof against any losses, claims, damages, or liabilities (joint or several) to which they may become subject under the Act, or the 1934 Act or other federal or state law, insofar as such losses, claims, damages, or liabilities (or actions in respect thereof) arise out of or are based upon any of the following statements, omissions or violations (collectively a "Violation"): (i) any untrue statement or alleged untrue statement of a material fact contained in such registration statement, including any preliminary prospectus or final prospectus contained therein or any amendments or supplements thereto, (ii) the omission or alleged omission to state therein a material fact required to be stated therein, or necessary to make the statements therein not misleading, or (iii) any violation or alleged violation by the Company of the Act, the 1934 Act, any state securities law or any rule or regulation promulgated under the Act, or the 1934 Act or any state securities law; and the Company will pay to each such Holder, underwriter or controlling person, and each officer, director, employee and agent thereof as incurred, any legal or other expenses reasonably incurred by them in connection with investigating or defending any such loss, claim, damage, liability, or action; provided, however, that the indemnity agreement contained in

this subsection 1.7(a) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability, or action if such settlement is effected without the consent of the Company (which consent shall not be unreasonably withheld), nor shall the Company be liable in any such case for any such loss, claim, damage, liability, or action to the extent that it arises out of or is based upon a Violation which occurs in reliance upon and in conformity with written information furnished expressly for use in connection with such registration by any such Holder, underwriter or controlling person.

(b) To the extent permitted by law, each selling Holder (severally and not jointly) will indemnify and hold harmless the Company, each of its directors, each of its officers who has signed the registration statement, each person, if any, who controls the Company within the meaning of the Act, any underwriter, any other Holder selling securities in such registration statement and any controlling person of any such underwriter or other Holder, against any losses, claims, damages, or liabilities (joint or several) to which any of the foregoing persons may become subject, under the Act, or the 1934 Act or other federal or state law, insofar as such losses, claims, damages, or liabilities (or actions in respect thereto) arise out of or are based upon any Violation, in each case to the extent (and only to the extent) that such Violation occurs in reliance upon and in conformity with written information furnished by such Holder expressly for use in connection with such registration; and each such Holder will pay, as incurred, any legal or other expenses reasonably incurred by any person intended to be indemnified pursuant to this subsection 1.7(a), in connection with investigating or defending any such loss, claim, damage, liability, or action; provided, however, that the indemnity agreement contained in this subsection 1.7(a) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of the Holder, which consent shall not be unreasonably withheld; provided, that, in no event shall any indemnity under this subsection 1.10(b) exceed the gross proceeds from the offering received by such Holder.

(c) Promptly after receipt by an indemnified party under this Section 1.7 of notice of the commencement of any action (including any governmental action), such indemnified party will, if a claim in respect thereof is to be made against any indemnifying party under this Section 1.7, deliver to the indemnifying party a written notice of the commencement thereof and the indemnifying party shall have the right to participate in, and, to the extent the indemnifying party so desires, jointly with any other indemnifying party similarly noticed, to assume the defense thereof with counsel mutually satisfactory to the parties; provided, however, that an indemnified party (together with all other indemnified parties which may be represented without conflict by one counsel) shall have the right to retain one separate counsel, with the fees and expenses to be paid by the indemnifying party, if representation of such indemnified party by the counsel retained by the indemnifying party would be inappropriate due to actual or potential differing interests between such indemnified party and any other party represented by such counsel in such proceeding. The failure to deliver written notice to the indemnifying party within a reasonable time of the commencement of any such action, if prejudicial to its ability to defend such action, shall relieve such indemnifying party of any liability to the indemnified party under this Section 1.7, but the omission so to deliver written notice to the indemnifying party will not relieve it of any liability that it may have to any indemnified party otherwise than under this Section 1.7.

(d) If the indemnification provided for in this Section 1.7 is held by a court of competent jurisdiction to be unavailable to an indemnified party with respect to any loss, liability, claim, damage, or expense referred to therein, then the indemnifying party, in lieu of indemnifying such indemnified party hereunder, shall contribute to the amount paid or payable by such indemnified party as a result of such loss, liability, claim, damage, or expense in such proportion as is appropriate to reflect the relative fault of the indemnifying party on the one hand and of the indemnified party on the other in connection with the statements or omissions that resulted in such loss, liability, claim, damage, or expense as well as any other relevant equitable considerations. The relative fault of the indemnifying party and of the indemnified party shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission to state a material fact relates to information supplied by the indemnifying party or by the indemnified party and the parties' relative intent, knowledge, access to information, and opportunity to correct or prevent such statement or omission.

(e) Notwithstanding the foregoing, to the extent that the provisions on indemnification and contribution contained in the underwriting agreement entered into in connection with the underwritten public offering are in conflict with the foregoing provisions, the provisions in the underwriting agreement shall control.



(f) The obligations of the Company and Holders under this Section 1.7 shall survive the completion of any offering of Registrable Securities in a registration statement under this Section 1, and otherwise.

1.8 Assignment of Registration Rights. The rights to cause the Company to register Registrable Securities pursuant to this Section 1 may be assigned (but only with all related obligations) by a Holder to a transferee or assignee of such securities, provided: (a) the Company is, within a reasonable time after such transfer, furnished with written notice of the name and address of such transferee or assignee and the securities with respect to which such registration rights are being assigned; (b) such transferee or assignee agrees in writing to be bound by and subject to the terms and conditions of this Agreement; and (c) such assignment shall be effective only if immediately following such transfer the further disposition of such securities by the transferee or assignee is restricted under the Act.

1.9 Termination of Registration Rights. No Holder shall be entitled to exercise any right provided for in this Section 1 after the fifth anniversary of the date of this Agreement.

1.10 Reports Under 1934 Act. With a view to making available to the Holders the benefits of Rule 144 promulgated under the Act and any other rule or regulation of the SEC that may at any time permit a Holder to sell Registrable Securities to the public without registration, the Company agrees to:

(a) make and keep available public information, as those terms are understood and defined in Rule 144;

(b) file with the SEC in a timely manner all reports and other documents required of the Company under the Act and the 1934 Act; and

(c) furnish to a Holder owning any Registrable Securities upon request (i) a written statement by the Company that it has complied with the reporting requirements of Rule 144 (at any time after 90 days after the effective date of the first registration statement filed by the Company for an offering of its securities to the general public), the Act and the 1934 Act (at any time after the Company has become subject to the reporting requirements of the 1934 Act), (ii) a copy of the most recent annual or quarterly report of the company and such other reports and documents so filed by the Company, and (iii) such other information as may be reasonably required in availing any Holder of Registrable Securities of any rule or regulation of the SEC which permits the selling of any such Registrable Securities without registration or pursuant to such form (at any time after the company has become subject to the reporting requirements of the 1934 Act).

1.11 Granting of Registration Rights. The Company shall not, without the prior written consent of the Holders of at least 50.1% of the Registrable Securities then outstanding, grant any rights to any persons to register any shares of capital stock or other securities of the Company that would limit the Holders' proportional rights under Section 1.2(b). The grant of registration rights to any person that would entitle such person to participate on a pro rata basis in an offering under Section 1.2(b) shall not be deemed a limitation to the Holders' proportional rights under Section 1.2(b), pursuant to this Section 1.11; provided that in no circumstance will fewer than ten percent (10%) of the shares to be underwritten pursuant to Section 1.2(b) be allocated to the Holders, regardless of any subsequent registration rights granted by the Company.

## 2. Miscellaneous.

2.1 Successors and Assigns. Except as otherwise provided herein, the terms and conditions of this Agreement shall inure to the benefit of and be binding upon the respective successors and assigns of the parties (including transferees of any shares of Registrable Securities). Nothing in this Agreement, express or implied, is intended to confer upon any party other than the parties hereto or their respective successors and assigns any rights, remedies, obligations, or liabilities under or by reason of this Agreement, except as expressly provided in this Agreement.

2.2 Governing Law. This Agreement shall be governed by and construed under the laws of the Commonwealth of Pennsylvania without regard to its conflict of laws principles.

2.3 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

2.4 Titles and Subtitles. The titles and subtitles used in this Agreement are used for convenience only and are not to be considered in construing or interpreting this Agreement.

2.5 Notices. Unless otherwise provided, any notice required or permitted under this Agreement shall be given in writing and shall be deemed effectively given upon personal delivery to the party to be notified or upon deposit with the United States Post Office, by registered or certified mail, postage prepaid and addressed to the party to be notified at the address indicated for such party on the signature page hereof, or at such other address as such party may designate by ten (10) days' advance written notice to the other parties.

2.6 Expenses. If any action at law or in equity is necessary to enforce or interpret the terms of this Agreement, the prevailing party shall be entitled to reasonable attorneys' fees, costs and necessary disbursements in addition to any other relief to which such party may be entitled.

2.7 Amendments and Waivers. Any term of this Agreement may be amended and the observance of any term of this Agreement may be waived (either generally or in a particular instance and either retroactively or prospectively), only with the written consent of the Company and the holders of a majority of the Registrable Securities then outstanding. Any amendment or waiver effected in accordance with this paragraph shall be binding upon each holder of any Registrable Securities then outstanding, each future holder of all such Registrable Securities, and the Company.

2.8 Severability. If one or more provisions of this Agreement are held to be unenforceable under applicable law, such provision shall be excluded from this Agreement and the balance of the Agreement shall be interpreted as if such provision were so excluded and shall be enforceable in accordance with its terms.

2.9 Aggregation of Stock. All shares of Registrable Securities held or acquired by affiliated entities or persons shall be aggregated together for the purpose of determining the availability of any rights under this Agreement.

2.10 Entire Agreement; Amendment; Waiver; No Further Rights. This Agreement (including the Exhibits hereto, if any) constitutes the full and entire understanding and agreement between the parties with regard to the subjects hereof and thereof. The Stockholders hereby agree that they have no further rights under the ATI Registration Rights Agreement.

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IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first above written.

DISCOVERY LABORATORIES, INC.

By:

-----  
Robert J. Capetola, Ph.D.  
President

Address: \_\_\_\_\_  
\_\_\_\_\_

Stockholders:

JOHNSON & JOHNSON DEVELOPMENT CORPORATION

By:

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Address: \_\_\_\_\_  
\_\_\_\_\_

THE SCRIPPS RESEARCH INSTITUTE

By:

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Address: \_\_\_\_\_  
\_\_\_\_\_

[FORM OF LOCK-UP]

\_\_\_\_\_, 1998

Discovery Laboratories, Inc.  
509 Madison Avenue, 14th Floor  
New York, New York 10022

Ladies and Gentlemen:

This letter agreement is in connection with the Agreement and Plan of Merger dated as of March 5, 1998 (the "Merger Agreement") by and among Discovery Laboratories, Inc., a Delaware corporation (the "Company"), ATI Acquisition Corp., a Delaware corporation and a wholly-owned subsidiary of the Company ("Acquisition Sub"), and Acute Therapeutics, Inc., a Delaware corporation ("Acute") pursuant to which, subject to the terms and conditions of the Merger Agreement, the undersigned may receive securities of the Company (the "Merger Securities").

In consideration of the foregoing and in order to induce you to consummate the merger of Acquisition Sub with and into Acute pursuant to the Merger Agreement (the "Merger"), the undersigned hereby irrevocably agrees that it will not on or before November 25, 1998, directly or indirectly, sell, offer, contract to sell, transfer the economic risk of ownership in, make any short sale, pledge or otherwise dispose of any shares of the Company's Common Stock, or any securities convertible into or exchangeable or exercisable for or any other rights to purchase or acquire the Company's Common Stock, in each case which are attributable to the Merger Securities, without the prior written consent of the Company.

Notwithstanding the foregoing, if the undersigned is an individual, he or she may transfer any shares of Common Stock or securities convertible into or exchangeable or exercisable for the Company's Common Stock, in each case which are attributable to the Merger Securities, either during his or her lifetime or on death by will or intestacy to his or her immediate family or to a trust the beneficiaries of which are exclusively the undersigned and/or a member or members of his or her immediate family; provided, however, that prior to any such transfer each transferee shall execute an agreement, satisfactory to the Company, pursuant to which each transferee shall agree to receive and hold such shares of Common Stock, or securities convertible into or exchangeable or exercisable for the Common Stock, subject to the provisions hereof, and there shall be no further transfer except in accordance with the provisions hereof. For the purposes of this paragraph, "immediate family" shall mean lineal descendant, father, mother, brother or sister of the transferor.

The undersigned understands that the agreements of the undersigned are irrevocable and shall be binding upon the undersigned's heirs, legal representatives, successors and assigns. The undersigned agrees and consents to the entry of stop transfer instructions with the Company's transfer agent against the transfer of the Company's Common Stock or other securities of the Company received by the undersigned pursuant to the Merger Agreement except in compliance with this agreement and further agrees that any stock certificates of the Company, and any other document evidencing ownership of securities of the Company, issued to the undersigned pursuant to the Merger Agreement shall bear restrictive legends prohibiting transfers except in accordance with the terms of this letter.

This agreement shall be governed by and construed in accordance with the laws of the State of Delaware as applied to agreements entered into and performed by Delaware residents and entirely to be performed within Delaware.

Very truly yours,

Dated: \_\_\_\_\_

\_\_\_\_\_  
Signature

-----  
Printed Name and Title

## MANAGEMENT AGREEMENT

This Management Agreement (the "Agreement"), is made and entered into as of the 5th day of March, 1998, by and between Discovery Laboratories, Inc., a Delaware corporation ("Discovery"), and Acute Therapeutics, Inc., a Delaware corporation ("ATI").

## RECITALS

A. Discovery, ATI and ATI Acquisition Corp., a Delaware corporation and a wholly-owned subsidiary of Discovery ("Acquisition Subsidiary"), have entered into an Agreement and Plan of Merger and Reorganization dated as of the date hereof (the "Merger Agreement"), pursuant to which ATI will become a wholly-owned subsidiary of Discovery through a merger of Acquisition Subsidiary into ATI, upon the terms and subject to the conditions set forth in the Merger Agreement (the "Merger"). Capitalized terms used in this Agreement and not otherwise defined herein shall have the same meanings as in the Merger Agreement.

B. Discovery is a development stage pharmaceutical company engaged in the development of proprietary pharmaceuticals to treat post-menopausal osteoporosis, cystic fibrosis and other diseases. ATI is a development stage pharmaceutical company engaged in the development of acute care pharmaceuticals to treat Acute Respiratory Distress Syndrome, Meconium Aspiration Syndrome and Idiopathic Respiratory Distress Syndrome.

C. The closing under the Merger Agreement (the "Closing") is scheduled to occur following satisfaction of all of the conditions to Closing set forth in the Merger Agreement but no later than July 15, 1998.

D. Discovery and ATI wish to provide for a smooth and efficient transition and integration of the businesses of Discovery and ATI, pending the closing of the transactions provided for in the Merger Agreement. In furtherance of this transition, Discovery has requested and ATI has agreed that the ATI management personnel (the "ATI Management Team") will manage the operations of both Discovery and ATI through the effective date of the Merger (the "Effective Date"), with each member of the ATI Management Team assuming responsibilities on behalf of, and a title at, Discovery comparable to the responsibilities and title held by such individual at ATI.

NOW, THEREFORE, in consideration of the foregoing premises and the mutual covenants herein contained, IT IS AGREED AS FOLLOWS:

## I. Management Services:

A. Subject to the terms and conditions set forth in this Agreement, Discovery hereby engages ATI to provide, and ATI hereby accepts such engagement and agrees to provide, operational, transition and integration management services to Discovery. ATI shall provide such services by making available to Discovery each member of the ATI Management Team whose entry into an employment agreement with Discovery is a condition to any party's obligations under the Merger Agreement. During the term of this Agreement, the ATI Management Team shall be responsible for the overall management of the operations of Discovery and shall report to, and shall be subject to the policies established by, Discovery's Board of Directors. Notwithstanding the foregoing, no member of the ATI Management Team shall have the authority by virtue of this Agreement to participate in any meeting of the Board of Directors of Discovery or any committee thereof except upon invitation. Moreover, Discovery does not delegate to ATI under this Agreement any powers, duties or responsibilities which it is prohibited by law from delegating.

B. Each member of the ATI Management Team shall have duties and responsibilities on behalf of Discovery comparable to the duties and responsibilities of such individual at ATI. Each such individual shall have the same title at Discovery as he or she has at ATI, with the additional designation "Acting," as set forth on Schedule A hereto.

C. During the term of this Agreement, management and supervisory personnel of Discovery shall report to Robert J. Capetola, Ph.D., who will serve as the Acting President and Chief Executive Officer of Discovery.

II. Option Grants. The ATI Management Team shall be granted, on the date of this Agreement, options to purchase an aggregate of 126,500 shares of Discovery Common Stock (allocated as per attached Schedule B), which shall vest in accordance with Schedule B. Notwithstanding Schedule B, if the Merger has not occurred by July 15, 1998, due to the failure of

Discovery or its stockholders to perform any of their obligations under the Merger Agreement, all such options shall be immediately vested in full.

III. Term and Termination. The term of this Agreement ("Term") shall commence on the date of this Agreement and shall terminate on the earliest to occur of (i) the Effective Date or (ii) termination of the Merger Agreement.

IV. Compensation. If the Merger is consummated, no compensation shall be payable to ATI or the ATI Management Team other than the options granted pursuant to Section II hereof. If the Merger is not consummated on or prior to July 15, 1998 due to the failure of Discovery or its stockholders to perform any of their obligations under the Merger Agreement, Discovery shall pay to ATI on the date of termination or July 15, 1998, whichever occurs first (the "Date of Termination"), 50% of the salary expense attributable to the ATI Management Team from the date of this Agreement through the Date of Termination and all the options granted pursuant to Section II hereof shall be immediately vested in full.

V. Indemnification.

A. Benefits Indemnification. Except as specifically provided in Section IV hereof, Discovery and ATI shall each be liable for any wages or benefits earned or accrued by each of its employees and owing to them under applicable law, their respective policies and procedures or otherwise and each of Discovery and ATI shall indemnify, defend and hold harmless each other party and its respective employees from and against any and all costs, expenses and liabilities with respect thereto (the "Benefits Indemnity"). The parties specifically acknowledge and agree that in the event of the termination of this Agreement other than upon the Closing, such Benefits Indemnity shall survive the termination of this Agreement.

B. Director and Officer Indemnification. The ATI Management Team shall be indemnified by Discovery with respect to their actions as acting officers of Discovery during the term of this Agreement to the same extent that Discovery's officers and directors are indemnified by Discovery.

VI. Assignment. This Agreement and the duties hereunder shall not be assigned or delegated in whole or in part by either party, it being understood and agreed that this Agreement is personal to Discovery and ATI.

VII. Notices. All notices required or permitted hereunder shall be given in writing and shall be delivered in the manner and at the addresses set forth in the Merger Agreement.

VIII. Relationship of the Parties. The relationship of the parties shall be that of independent contractors and all acts performed by ATI during the Term by ATI shall be deemed to be performed in its capacity as an independent contractor. Nothing contained in this Agreement is intended to or shall be construed to give rise to or create a partnership or joint venture between Discovery, its successors and assigns on the one hand, and ATI, its successors and assigns on the other hand. With respect to situations that involve a potential conflict of interest between Discovery and ATI in the course of ATI's duties under this Agreement, unless otherwise specifically agreed between Discovery and ATI, the employees of ATI shall be deemed to act only on behalf of ATI and the employees of Discovery shall be deemed to act only on behalf of Discovery.

IX. Entire Agreement, Governing Law. This Agreement contains the entire agreement between the parties with respect to the subject matter hereof and shall be binding upon and inure to the benefit of their successors, and shall be interpreted, construed, governed and enforced in accordance with the laws of the State of New York, without regard to conflicts of law principles of such state. This Agreement may not be modified or amended except by written instrument signed by both of the parties hereto.

X. Captions. The captions used herein are for convenience of reference only and shall not be construed in any manner to limit or modify any of the terms hereof.

XI. Severability. In the event one or more of the provisions contained in this Agreement is deemed to be invalid, illegal or unenforceable in any respect under applicable law, the validity, legality and enforceability of the remaining provisions hereof shall not in any way be impaired thereby.

XII. Cumulative; No Waiver. A right or remedy herein conferred upon or reserved to either of the parties hereto is intended to be cumulative of any



other right or remedy, and each and every right and remedy shall be cumulative and in addition to any other right or remedy given hereunder, or now or hereafter legally existing upon the occurrence of an event of default hereunder. The failure of either party hereto to insist at any time upon the strict observance or performance of any of the provisions of this Agreement or to exercise any right or remedy as provided in this Agreement shall not impair any such right or remedy or be construed as a waiver or relinquishment thereof with respect to subsequent defaults. Every right and remedy given by this Agreement to the parties hereof may be exercised from time to time and as often as may be deemed expedient by the

parties thereto, as the case may be.

XIII. Authorization for Agreement. Each of Discovery and ATI represents and warrants that the execution and performance of this Agreement by Discovery and ATI have been duly authorized by all necessary resolutions and corporate action, and this Agreement constitutes the valid and enforceable obligations of Discovery and ATI in accordance with its terms.

XIV. Counterparts. This Agreement may be executed in any number of counterparts, each of which shall be an original, and all such counterparts shall together constitute but one and the same Agreement.

XV. No Effect on Merger Agreement. Each of the parties hereby acknowledges and agrees that entry into this Agreement, and the performance of their respective obligations hereunder, shall have no effect on the Merger Agreement including, without limitation, the

satisfaction of the conditions thereto or any rights of the parties with respect to termination thereof.

IN WITNESS WHEREOF, the parties have hereto caused this Agreement to be duly executed, as of the day and year first above written.

DISCOVERY LABORATORIES, INC.

/s/ James S. Kuo

-----  
By: James S. Kuo, M.D.  
Its: President

ACUTE THERAPEUTICS, INC.

/s/ Robert J. Capetola

-----  
By: Robert J. Capetola, Ph.D.  
Its: President and Chief Executive Officer

SCHEDULE A  
ATI MANAGEMENT TEAM

Name - - - - -	Title - - - - -
Harry G. Brittain, Ph.D.	Acting Vice President of Pharmaceutical Development
Robert J. Capetola, Ph.D.	Acting President and Chief Executive Officer
Cynthia Davis	Acting Controller
Laurence B. Katz, Ph.D.	Acting Vice President of Project Administration and Clinical Administration
Lisa Mastroianni	Acting Director of Clinical Evaluation
Christopher Schaber	Acting Vice President of Regulatory Affairs and Quality Assurance
Huei Tsai, Ph.D.	Acting Vice President of Biometrics
Thomas Wiswell, M.D.	Acting Vice President of Clinical Research
Joan Marie Brown	

SCHEDULE B

Name	Options to be Issued*
- - - - -	- - - - -
Harry G. Brittain, Ph.D.	14,813
Joan Marie Brown	670
Robert J. Capetola, Ph.D.	43,010*/
Cynthia Davis	4,428
Laurence B. Katz, Ph.D.	14,813
Lisa Mastroianni	4,326
Christopher Schaber	14,813
Huei Tsai, Ph.D.	14,813
Thomas Wiswell, M.D.	14,813
Total	126,500
	=====

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\* All options, other than those granted to Robert J. Capetola, will vest in three equal annual installments, the first installment of which will vest on the first year anniversary of the Closing of the Merger; notwithstanding the foregoing, if the Merger has not occurred by July 15, 1998 due to the failure of Discovery or its stockholders to perform any of their obligations under the Merger Agreement, all such options shall be immediately vested in full.

\*/ These option vest in full on the date of grant.

## Discovery Laboratories and Acute Therapeutics Enter Into Agreement and Plan of Merger

NEW YORK, March 10, 1998--Discovery Laboratories, Inc. (Discovery) (Nasdaq: DSCO, DSCOU) announced today that it has entered into an Agreement and Plan of Merger with its majority-owned subsidiary, Acute Therapeutics, Inc. (ATI) and ATI Acquisition Corp. pursuant to which Discovery will acquire all outstanding shares of common stock of ATI through a merger of ATI Acquisition Corp. into ATI. The merger will result in 100% ownership by Discovery of ATI's product portfolio and is expected to strengthen Discovery's management team and consolidate development activities. Discovery's headquarters will be relocated to ATI's Doylestown, Pa. location. Upon consummation of the merger, the stockholders of ATI will be issued 3.91 shares of Discovery common stock in exchange for each share of ATI common stock held by them prior to the transaction (the exchange ratio). Certain outstanding ATI options for the purchase of ATI common stock will be assumed by Discovery and will become exercisable for shares of Discovery common stock on the basis of the exchange ratio.

Discovery and ATI have also entered into a Management Agreement providing for the management of Discovery by the ATI management team pending completion of the merger. Pursuant to the Management Agreement, members of the ATI management team have been granted options to purchase 126,500 shares of Discovery common stock, subject to vesting.

The transaction is subject to approval by the stockholders of Discovery and ATI and a number of other conditions, including the execution of employment agreements by Robert J. Capetola, Ph.D. (currently Chief Executive Officer of ATI) and other key executives of ATI and the election at Discovery's 1998 Annual Meeting of a Board of Directors of Discovery consisting of six of Discovery's current directors (three of whom are also directors of ATI) and four of ATI's current directors. In addition, pursuant to their employment agreements with Discovery, the ATI management team will be granted, in the aggregate, options to purchase (i) 338,500 shares of Discovery common stock subject to vesting, (ii) 175,000 shares of Discovery common stock at such time as the market capitalization of Discovery exceeds \$75 million and (iii) 160,000 shares of Discovery common stock upon consummation of a corporate partnering deal having a total value of at least \$20 million. The Discovery common stock to be issued to ATI stockholders and the ATI options to be assumed in the merger, together with the options to be issued to ATI management members pursuant to their employment agreements with Discovery and the options granted pursuant to the Management Agreement, will represent approximately 24% of Discovery's common stock on a fully-diluted basis.

ATI's lead product in development is Surfaxin(TM) for the treatment of acute respiratory distress syndrome (ARDS). Surfaxin(TM) is a novel, proprietary, peptide-containing lung surfactant invented at The Scripps Research Institute. The peptide is KL4, a 21 amino acid peptide modeled after the important SP-B protein in the human surfactant system. Lung surfactants are protein-lipid complexes that coat the airsacs of the lung and facilitate oxygen exchange with blood. ARDS is an acute generalized inflammatory disease of the lung affecting approximately 150,000 persons per year in the U.S. and has an associated mortality rate of approximately 50%. As previously announced on February 9, 1998, ATI has completed its Phase 1B clinical trial of Surfaxin(TM) in ARDS.

Discovery Laboratories, Inc. is a New York City based development stage pharmaceutical company that is clinically developing proprietary pharmaceuticals to treat post-menopausal osteoporosis, cystic fibrosis and other diseases. ATI, a Doylestown, Pa. company, concentrates its efforts on developing acute care pharmaceuticals and is actively developing therapies for ARDS, meconium aspiration syndrome and idiopathic respiratory distress syndrome. Discovery's strategy is to accelerate and lower the risk of drug development by acquiring and developing proprietary pharmaceuticals for which significant animal and human testing has already been completed. In addition, Discovery seeks to minimize the cost of drug development by outsourcing preclinical development and manufacturing. More information about Discovery is available on the company's web site at: [www.discoverylabs.com](http://www.discoverylabs.com)

To the extent that statements in this press release are not strictly historical, including statements as to future financial conditions, events conditioned on stockholder or other approval, or otherwise as to future events, such statements are forward-looking, and are made pursuant to the safe harbor provisions of the Securities Litigation Reform Act of 1995. The forward-looking statements contain in this release are subject to certain risks and uncertainties that could cause actual results to differ materially from the statements made. Among the factors which could affect the Company's actual results and could cause results to differ from those contained in the forward-looking statements contained herein are the risk that financial conditions may change, risks relating to the

progress of the Company's research and development and the development of competing therapies and/or technologies by other companies. Those associated risks and others are further

described in the Company's filings with the Securities and Exchange Commission.

Contact:

Robert J. Capetola, Ph.D.  
Chairman & Chief Executive Officer  
Acute Therapeutics, Inc.  
215/794-3064

or

Steve H. Kanzer, CPA, Esq.  
Chairman  
Discovery Laboratories, Inc.  
212/554-4330

or

Dian Griesel, Ph.D.  
The Investor Relations Group, Inc.  
212/664-8489