UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2010

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 000-26422

DISCOVERY LABORATORIES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-3171943**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

2600 Kelly Road, Suite 100
Warrington, Pennsylvania 18976-3622
(Address of principal executive offices)

(215) 488-9300
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES o NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES o NO x

As of November 12, 2010, 206,652,815 shares of the registrant's common stock, par value $0.001 per share, were outstanding.

Table of Contents

PART I - FINANCIAL INFORMATION

Unless the context otherwise requires, all references to "we," "us," "our," and the "Company" include Discovery Laboratories, Inc., and its wholly-owned, presently inactive subsidiary, Acute Therapeutics, Inc.

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The forward-looking statements are only predictions and provide our current expectations or forecasts of future events and financial performance and may be identified by the use of forward-looking terminology, including the terms "believes," "estimates," "anticipates," "expects," "plans," "intends," "may," "will" or "should" or, in each case, their negative, or other variations or comparable terminology, though the absence of these words does not necessarily mean that a statement is not forward-looking. Forward-looking statements include all matters that are not historical facts and include, without limitation statements concerning: our business strategy, outlook, objectives, future milestones, plans, intentions, goals, and future financial condition, including the period of time for which our existing resources will enable us to fund our operations; plans regarding our efforts to gain U.S. regulatory approval for our lead product, Surfaxin® (lucinactant) for the prevention of respiratory distress syndrome (RDS) in premature infants; the possibility, timing and outcome of submitting regulatory filings for our products under development; our research and development programs for our KL_4 surfactant technology and our capillary aerosolization technology platform, including planning for and timing of any clinical trials and potential development milestones; the development of financial, clinical, manufacturing and distribution plans related to the potential commercialization of our drug products, if approved; and plans regarding potential strategic alliances and other collaborative arrangements with pharmaceutical companies and others to develop, manufacture and market our products.

We intend that all forward-looking statements be subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to many risks and uncertainties that could cause actual results to differ materially from any future results expressed or implied by the forward-looking statements. We caution you therefore against relying on any of these forward-looking statements. They are neither statements of historical fact nor guarantees or assurances of future performance. Examples of the risks and uncertainties include, but are not limited to:

- risks related generally to our efforts to gain regulatory approval, in the United States and elsewhere, for our drug product candidates, including our lead products that we are developing to address respiratory distress syndrome (RDS) in premature infants: Surfaxin for the prevention of RDS, Surfaxin LS™ (our lyophilized KL_4 surfactant) and Aerosurf® (our initial aerosolized KL_4 surfactant);

- the risk that we and the U.S. Food and Drug Administration (FDA) or other regulatory authorities will not be able to agree on matters raised during the regulatory review process, or that we may be required to conduct significant additional activities to potentially gain approval of our product candidates, if ever;

- the risk that the FDA or other regulatory authorities may not accept, or may withhold or delay consideration of, any applications that we may file, or may not approve our applications or may limit approval of our products to particular indications or impose unanticipated label limitations;

- risks relating to the rigorous regulatory approval processes, including pre-filing activities, required for approval of any drug or combination drug-device products that we may develop, whether independently, with strategic development partners or pursuant to collaboration arrangements;

- the risk that the FDA will not be satisfied with the results of our efforts to optimize and revalidate our fetal rabbit biological activity test (BAT) and to demonstrate that the BAT has the ability to distinguish change in Surfaxin drug product over time, which is needed to advance our KL_4 surfactant pipeline;

- the risk that changes in the national or international political and regulatory environment may make it more difficult to gain FDA or other regulatory approval of our drug product candidates;

- risks relating to our research and development activities, which involve time-consuming and expensive preclinical studies and other efforts, and potentially multiple clinical trials, which may be subject to potentially significant delays or regulatory holds, or fail, and which must be conducted using sophisticated and extensive analytical methodologies, including an acceptable biological activity test, if required, as well as other quality control release and stability tests to satisfy the requirements of the regulatory authorities;

- risks relating to our ability to develop and manufacture drug products and drug-device combination products based on our capillary aerosolization technology for clinical studies and, if approved, for commercialization of our products;

- risks relating to the transfer of our manufacturing technology to third-party contract manufacturers and assemblers;

- the risk that we, our contract manufacturers or any of our third-party suppliers may encounter problems or delays in manufacturing or assembling drug products, drug product substances, capillary aerosolization devices and related components and other materials on a timely basis or in an amount sufficient to support our development efforts and, if our products are approved, commercialization;

- the risk that we may be unable to identify potential strategic partners or collaborators with whom we can develop and, if approved, commercialize our products in a timely manner, if at all;

- the risk that we or our strategic partners or collaborators will not be able to attract or maintain qualified personnel;

- the risk that, if approved, market conditions, the competitive landscape or otherwise may make it difficult to launch and profitably sell our products;

- the risk that we may not be able to raise additional capital or enter into strategic alliances or collaboration agreements (including strategic alliances for development or commercialization of our drug products and combination drug-device products);

- risks that the unfavorable credit environment will adversely affect our ability to fund our activities, that our share price may not remain at the price level necessary for us to access capital under our Committed Equity Financing Facilities (CEFFs), that the CEFFs may expire before we are able to access the full dollar amount potentially available thereunder, and that additional equity financings could result in substantial equity dilution;

- the risk that we will be unable to regain compliance with the Minimum Bid Price Requirement of The Nasdaq Capital Market® (Nasdaq Capital Market) prior to the expiration of the grace period currently in effect, which could increase the probability that our stock will be delisted from Nasdaq, which could cause our stock price to decline, and that, to retain our listing on the Nasdaq Capital Market, we may have to implement a reverse stock split, which could result in a reduction in our total market capitalization;

- the risk that recurring losses, negative cash flows and an inability to raise sufficient additional capital could threaten our ability to continue as a going concern;

- the risks that we may be unable to maintain and protect the patents and licenses related to our products and that other companies may develop competing therapies and/or technologies;

- the risk that we may become involved in securities, product liability and other litigation;

- the risk that the FDA may not approve Surfaxin or may subject the marketing of Surfaxin to onerous requirements that significantly impair marketing activities;

- the risk that we may identify unforeseen problems that have not yet been discovered or the FDA could in the future impose additional requirements to gain approval of Surfaxin;

- risks, if we succeed in gaining approval of Surfaxin and our other drug products, that reimbursement and health care reform may adversely affect us;

- the risk that we will not successfully remediate the recently-identified material weakness related to initial classification and accounting for registered warrants as liabilities or equity, which resulted in the restatement of our financial statements for periods ended June 30, 2009 through June 30, 2010; and

- other risks and uncertainties, including those described in our most recent Annual Report on Form 10-K and other filings with the Securities and Exchange Commission, on Forms 10-Q and 8-K, and any amendments thereto.

Pharmaceutical and biotechnology companies have suffered significant setbacks in advanced clinical trials, even after obtaining promising earlier trial results. Data obtained from such clinical trials are susceptible to varying interpretations, which could delay, limit or prevent regulatory approval. After gaining approval of a drug product, pharmaceutical companies face considerable challenges in marketing and distributing their products, and may never become profitable.

The forward-looking statements contained in this report or the documents incorporated by reference herein speak only of their respective dates. Factors or events that could cause our actual results to differ may emerge from time to time and it is not possible for us to predict them all. Except to the extent required by applicable laws, rules or regulations, we do not undertake any obligation to publicly update any forward-looking statements or to publicly announce revisions to any of the forward-looking statements, whether as a result of new information, future events or otherwise.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

DISCOVERY LABORATORIES, INC. AND SUBSIDIARY
Consolidated Balance Sheets
(in thousands, except per share data)

	September 30, 2010 (Unaudited)	December 31, 2009 (As Restated)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 14,654	$ 15,741
Prepaid expenses and other current assets	265	233
Total Current Assets	14,919	15,974
Property and equipment, net	3,804	4,668
Restricted cash	400	400
Other assets	175	361
Total Assets	$ 19,298	$ 21,403
LIABILITIES & STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 1,580	$ 1,294
Accrued expenses	3,947	3,446
Common stock warrant liability	2,508	3,191
Loan payable, including accrued interest	–	10,461
Equipment loans and capitalized leases, current portion	196	597
Total Current Liabilities	8,231	18,989
Equipment loans and capitalized leases, non-current portion	328	428
Other liabilities	640	690
Total Liabilities	9,199	20,107
Stockholders' Equity:		
Preferred stock, $0.001 par value; 5,000 shares authorized; no shares issued or outstanding	–	–
Common stock, $0.001 par value; 380,000 shares authorized; 199,186 and 126,689 shares issued, 198,873 and 126,376 shares outstanding	200	127
Additional paid-in capital	383,669	361,503
Accumulated deficit	(370,716)	(357,280)
Treasury stock (at cost); 313 shares	(3,054)	(3,054)
Total Stockholders' Equity	10,099	1,296
Total Liabilities & Stockholders' Equity	$ 19,298	$ 21,403

DISCOVERY LABORATORIES, INC. AND SUBSIDIARY
Consolidated Statements of Operations
(Unaudited)
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009** (As Restated)	**2010**	**2009** (As Restated)
Revenue	$ –	$ –	$ –	$ –
Expenses:				
Research and development	4,727	4,530	13,223	15,189
General and administrative	1,476	2,417	6,273	8,105
Total expenses	6,203	6,947	19,496	23,294
Operating loss	(6,203)	(6,947)	(19,496)	(23,294)
Change in fair value of common stock warrant liability	(365)	(1,662)	6,384	(2,985)
Other income / (expense):				
Interest and other income	3	8	27	29
Interest and other expense	(19)	(252)	(350)	(834)
Other income / (expense), net	(16)	(244)	(323)	(805)
Net loss	$ (6,584)	$ (8,853)	$ (13,435)	$ (27,084)
Net loss per common share – Basic and diluted	$ (0.03)	$ (0.07)	$ (0.08)	$ (0.24)
Weighted average number of common shares outstanding – basic and diluted	194,179	119,993	164,314	111,683

DISCOVERY LABORATORIES, INC. AND SUBSIDIARY
Consolidated Statements of Cash Flows
(Unaudited)
(in thousands)

	Nine Months Ended September 30,	
	2010	**2009**
		(As Restated)
Cash flows from operating activities:		
Net loss	$ (13,435)	$ (27,084)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,212	1,503
Stock-based compensation and 401(k) match	1,212	2,277
Fair value adjustment of common stock warrant	(6,384)	2,985
Gain on sale of equipment	(16)	–
Changes in:		
Prepaid expenses and other current assets	(32)	353
Accounts payable	286	(552)
Accrued expenses	501	(994)
Other assets	3	3
Other liabilities and accrued interest on loan payable	(2,011)	73
Net cash used in operating activities	(18,664)	(21,436)
Cash flows from investing activities:		
Purchase of property and equipment	(101)	(88)
Restricted cash	–	200
Proceeds from sales or maturity of marketable securities	–	2,047
Net cash used in investing activities	(101)	2,159
Cash flows from financing activities:		
Proceeds from issuance of securities, net of expenses	26,727	16,514
Principal payments under loan and capital lease obligations	(9,049)	(2,298)
Net cash provided by financing activities	17,678	14,216
Net decrease in cash and cash equivalents	(1,087)	(5,061)
Cash and cash equivalents – beginning of period	15,741	22,744
Cash and cash equivalents – end of period	$ 14,654	$ 17,683
Supplementary disclosure of cash flows information:		
Interest paid	$ 2,115	$ 183
Non-cash transactions:		
Unrealized loss on marketable securities	–	(1)
Equipment acquired through capitalized lease	48	–

Notes to Consolidated Financial Statements (unaudited)

Note 1 – The Company and Basis of Presentation

The Company

Discovery Laboratories, Inc. (referred to as "we," "us," or the "Company") is a biotechnology company developing surfactant therapies to treat respiratory disorders and diseases for which there frequently are few or no approved therapies. Our novel KL_4 proprietary technology produces a synthetic, peptide-containing surfactant (KL_4 surfactant) that is structurally similar to pulmonary surfactant, a substance produced naturally in the lung and essential for survival and normal respiratory function. In addition, our proprietary capillary aerosol-generating technology (capillary aerosolization technology) produces a dense aerosol with a defined particle size, to potentially deliver our aerosolized KL_4 surfactant to the lung. As many respiratory disorders are associated with surfactant deficiency or surfactant degradation, we believe that our proprietary technology platform makes it possible, for the first time, to develop a significant pipeline of surfactant products targeted to treat a wide range of previously unaddressed respiratory problems.

We are developing our lead products, Surfaxin® (lucinactant), Surfaxin LS™ and Aerosurf®, to address the most significant respiratory conditions affecting pediatric populations. In April 2009, we received a Complete Response Letter from the U.S. Food and Drug Administration (FDA) with respect to our New Drug Application (NDA) for Surfaxin for the prevention of respiratory distress syndrome (RDS) in premature infants, our first product based on our novel KL_4 surfactant technology. The letter focused primarily on certain aspects of our fetal rabbit biological activity test (BAT, a quality control and stability release test for Surfaxin and our other KL_4 pipeline products), specifically whether analysis of preclinical data from both the BAT and a well-established preterm lamb model of RDS demonstrates the degree of comparability that the FDA requires and whether the BAT can adequately distinguish change in Surfaxin biological activity over time. Currently, we believe that we are on track to submit a Complete Response to the FDA in the first quarter of 2011, which potentially could lead to approval of Surfaxin for the prevention of RDS in premature infants in 2011. If approved, Surfaxin would be the first synthetic, peptide-containing surfactant for use in neonatal medicine. For a detailed update of our development efforts with respect to Surfaxin, s*ee*, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Overview – Business and KL_4 Pipeline Programs Update" in this Quarterly Report on Form 10-Q.

Surfaxin LS, our lyophilized KL_4 surfactant, is a dry powder formulation that is resuspended as a liquid prior to use. Surfaxin LS is intended to improve ease of use for healthcare practitioners, eliminate the need for cold-chain storage, and potentially further improve clinical performance. Aerosurf is our proprietary KL_4 surfactant in aerosolized form, which we are developing using our capillary aerosolization technology, initially to treat premature infants at risk for RDS. Premature infants with RDS are treated with surfactants that are administered by means of invasive endotracheal intubation and mechanical ventilation, procedures that frequently result in serious respiratory conditions and complications. If approved, we believe that Aerosurf will make it possible to administer surfactant into the lung without subjecting patients to such invasive procedures. We believe that Aerosurf has the potential to enable a significant increase in the use of surfactant therapy in neonatal medicine.

In addition to our lead products, we plan over time to develop our KL_4 surfactant technology into a broad product pipeline that potentially will address a variety of debilitating respiratory conditions for which there currently are no or few approved therapies, in patient populations ranging from premature infants to adults. Our plans include potentially taking these initiatives through a Phase 2 proof-of-concept phase and, if successful, thereafter determining whether to seek strategic alliances or collaboration arrangements or to utilize other financial alternatives to fund their further development. In that regard, we recently completed a Phase 2 clinical trial of Surfaxin to potentially address Acute Respiratory Failure (ARF) and an investigator-initiated Phase 2a clinical trial assessing the safety, tolerability and effectiveness (via improvement in mucociliary clearance) of aerosolized KL_4 surfactant in patients with Cystic Fibrosis (CF). We are conducting research and preclinical development with our KL_4 surfactant potentially to address Acute Lung Injury (ALI), and, potentially in the future, other diseases associated with inflammation of the lung, such as Asthma and Chronic Obstructive Pulmonary Disease (COPD). We are also engaged in exploratory preclinical studies to assess the feasibility of using our KL_4 surfactant in combination with small and large molecule therapeutics to efficiently and effectively deliver therapies to the lung to treat a range of pulmonary conditions and disease. *See*, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Overview – Business and KL_4 Pipeline Programs Update" in this Quarterly Report on Form 10-Q.

An important priority continues to be to secure strategic and financial resources to potentially maximize the inherent value of our KL_4 surfactant technology. We prefer to accomplish our objectives through strategic alliances, including potential business alliances, and commercial and development partnerships. To advance the development of our lead products, we are engaged in discussions with potential strategic and/or financial partners. To secure required capital, we are also considering other alternatives, including additional financings and other similar opportunities. Although we continue to consider a number of potential strategic and financial alternatives, there can be no assurance that we will enter into any strategic alliance or otherwise consummate any financing or other similar transaction. Until such time as we secure the necessary capital, we plan to continue conserving our financial resources, predominantly by limiting investments in our pipeline programs.

Basis of Presentation

The accompanying interim unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information in accordance with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normally recurring accruals) considered for fair presentation have been included. Operating results for the three and nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2009 that we filed with the Securities and Exchange Commission (SEC) on March 10, 2010, as amended by Amendment No. 2 to our Annual Report on Form 10-K/A that we filed on with the SEC on November 15, 2010 (references to our 2009 Form 10-K in this Quarterly Report on Form 10-Q are intended to refer to our Form 10-K as amended by Amendment No. 2).

Note 2 – Restatement of Financial Statements

On November 15, 2010, we filed with the SEC (i) Amendment No. 2 to our Annual Report on Form 10-K for the year ended December 31, 2009 (Amendment No. 2) and (ii) Amendment No. 1 to each of our Quarterly Reports on Form 10-Q for the periods ended March 31, 2010 and June 30, 2010, in order to restate our consolidated balance sheets, consolidated statement of operations and statements of cash flows for the applicable periods to reclassify certain registered warrants based on a reassessment of applicable accounting guidance. As reported in Amendment No. 2, the restatements reclassify as derivative liabilities certain registered warrants that we issued in May 2009 and February 2010, which were originally recorded as equity, with such liabilities measured at fair value on the date of issue using the Black-Scholes option pricing model, with subsequent changes in the fair values recognized in our quarterly statement of operations as “Change in fair value of common stock warrant liability.” The amounts presented in this Quarterly Report on Form 10-Q reflect the reclassification of the warrants identified above. The restatements have had no impact on amounts previously reported for Assets; Revenues; Operating Expenses; Cash Flows; Loans, Equipment Loan and Accounts Payables; and Contractual Obligations.

Note 3 – Liquidity Risks and Management’s Plans

We have incurred substantial losses since inception, due to investments in research and development, manufacturing and potential commercialization activities and we expect to continue to incur substantial losses over the next several years. Historically, we have funded our business operations through various sources, including public and private securities offerings, draw downs under our Committed Equity Financing Facilities (CEFFs), capital equipment and debt facilities, and strategic alliances. We expect to continue to fund our business operations through a combination of these sources, as well as sales revenue from our product candidates, beginning with Surfaxin for the prevention of RDS, if approved.

Following receipt from the FDA of a Complete Response Letter for Surfaxin in April 2009, we made fundamental changes in our business strategy. We now believe that it is in our best interest financially to seek to develop and commercialize our KL_4 technology through strategic alliances or other collaboration arrangements, including in the United States. However, there can be no assurance that any strategic alliance or other arrangement will be successfully concluded.

The accompanying interim unaudited consolidated financial statements have been prepared assuming that we will continue as a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. As a result of our cash position as of December 31, 2009, the audit opinion we received from our independent auditors for the year ended December 31, 2009 contains a notation related to our ability to continue as a going concern. Our ability to continue as a going concern is dependent on our ability to raise additional capital, to fund our research and development and commercial programs and meet our obligations on a timely basis. If we are unable to successfully raise sufficient additional capital, through strategic and collaborative arrangements with potential partners and/or future debt and equity financings, we will likely not have sufficient cash flows and liquidity to fund our business operations, which could significantly limit our ability to continue as a going concern.

In addition, as of October 29, 2010, we have authorized capital available for issuance (and not otherwise reserved) of approximately 48.5 million shares of common stock. We have presented to our stockholders, for approval at our 2010 Annual Meeting of Stockholders on December 21, 2010, a proposal to authorize our Board of Directors (Board), in its sole discretion, to effect a share consolidation, or reverse stock split (reverse split) of our common stock, at a ratio of 1-for-15, on the terms described in the Proxy Statement. If implemented, a reverse split would result in a share consolidation of all outstanding shares of our common stock, but would not affect the number of authorized shares of capital stock provided in our Certificate of Incorporation. We, therefore, also submitted to our stockholders a proposal that, if and only if the reverse split is approved, would reduce the total number of authorized shares of common stock from 380 million to 50 million. If approved, these proposals will result in an increase in the number of shares of common stock available for issuance (and not otherwise reserved) and will allow us to potentially raise additional capital, through strategic and collaborative arrangements with potential partners and/or future debt and equity financings.

If for any reason, these proposals are not approved, we may be unable to undertake additional financings without first seeking stockholder approval, a process that would require a special meeting of stockholders, a time-consuming and expensive process that could impair our ability to efficiently raise capital when needed, if at all. In that case, we may be forced to further limit development of many, if not all, of our programs. If we are unable to raise the necessary capital, we may be forced to curtail all of our activities and, ultimately, potentially cease operations. Even if we are able to raise additional capital, such financings may only be available on unattractive terms, or could result in significant dilution of stockholders' interests and, in such event, the market price of our common stock may decline. Our financial statements do not include any adjustments relating to recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should we be unable to continue in existence.

Our future capital requirements depend upon many factors, including the success of our efforts to secure one or more strategic alliances or other collaboration arrangements, to support our product development activities and, if approved, commercialization plans. We are also considering other alternatives, including additional financings and other similar opportunities. There can be no assurance, however, that we will be able to secure strategic partners or collaborators to support and advise our activities, that our research and development projects will be successful, that products developed will obtain necessary regulatory approval, that any approved product will be commercially viable, that any CEFF will be available for future financings, or that we will be able to obtain additional capital when needed on acceptable terms, if at all. Even if we succeed in securing strategic alliances, raising additional capital and developing and subsequently commercializing product candidates, we may never achieve sufficient sales revenue to achieve or maintain profitability.

On April 28, 2010, we restructured our $10.6 million loan with PharmaBio Development Inc (PharmaBio), the former strategic investment subsidiary of Quintiles Transnational Corp. (Quintiles). The related Payment Agreement and Loan Amendment dated April 27, 2010 (PharmaBio Agreement) provided for (a) payment in cash of an aggregate of $6.6 million, representing $4.5 million in outstanding principal and $2.1 million in accrued interest, and (b) of the remaining $4 million principal amount under the loan, $2 million became due and was paid on each of July 30, 2010 and September 30, 2010. Also under the PharmaBio Agreement, PharmaBio surrendered to us for cancellation warrants to purchase an aggregate of 2,393,612 shares of our common stock that we had issued previously to PharmaBio in connection with the PharmaBio loan and a previous offering of securities. As of September 30, 2010, all of our obligations related to the loan with PharmaBio were paid in full.

Also, on April 27, 2010, we entered into a Securities Purchase Agreement with PharmaBio pursuant to which PharmaBio agreed to purchase 4,052,312 shares of our common stock and warrants to purchase an aggregate of 2,026,156 shares of common stock, sold as units consisting of one share and one-half of a warrant to purchase one share, at an offering price of $0.5429 per unit, resulting in gross proceeds to us, on April 29, 2010, of $2.2 million ($2.1 million net). The warrants generally will expire in April 2015 and generally will be exercisable beginning on October 28, 2010 at an exercise price per share of $0.7058 per share and, if exercised in full, would result in additional proceeds to us of approximately $1.4 million. *See*, Note 4 – Stockholders' Equity – Common Stock Offerings with PharmaBio Development Inc.

The PharmaBio Agreement also provides that we and PharmaBio will negotiate in good faith to potentially enter into a strategic arrangement under which PharmaBio would provide funding for a research collaboration between Quintiles and us relating to the possible research and development, and commercialization of two of our drug product candidates, Surfaxin LS and Aerosurf, for the prevention and treatment of RDS in premature infants. However, neither party is obligated to enter into any such arrangement except to the extent that the parties, in their individual and sole discretion, enter into definitive documents with respect thereto. Accordingly, there can be no assurances that any such arrangement will be completed.

On June 11, 2010, we entered into a Committed Equity Financing Facility (2010 CEFF) with Kingsbridge Capital Limited (Kingsbridge) under which we generally are entitled to sell, and Kingsbridge is obligated to purchase, from time to time over a period of three years, subject to certain conditions and restrictions, shares of our common stock for cash consideration of up to an aggregate of the lesser of $35 million or 31,597,149 shares. Kingsbridge's obligation to purchase shares of our common stock is subject to satisfaction of certain conditions at the time of each draw down, as specified in the Purchase Agreement. If at any time we fail to meet any of these conditions, we will not be able to access funds under the 2010 CEFF. In connection with the 2010 CEFF, we issued a warrant to Kingsbridge to purchase up to 1,250,000 shares of our common stock at a price of $0.4459 per share, which is fully exercisable (in whole or in part) beginning December 11, 2010 and for a period of five years thereafter. If exercised in full, the warrant potentially could result in additional proceeds to us of approximately $560,000. *See*, Note 4 – Stockholders' Equity.

On June 22, 2010, we completed a public offering of 35.7 million shares of our common stock, five-year warrants to purchase 17.9 million shares of our common stock, and short-term (nine month) warrants to purchase 17.9 million shares of our common stock. The securities were sold as units, with each unit consisting of one share of common stock, a five-year warrant to purchase one half share of common stock, and a short-term warrant to purchase one half share of common stock, at a public offering price of $0.28 per unit, resulting in gross proceeds to us of $10 million ($9.1 million net). If exercised in full, the short-term warrants would result in additional proceeds to us of approximately $5 million, and the long-term warrants, $7.1 million. This offering was made pursuant to our existing shelf registration statement on Form S-3 (File No. 333-151654), which was filed with the SEC on June 13, 2008 and declared effective by the SEC on June 18, 2008 (2008 Shelf Registration Statement). *See*, Note 4 – Stockholders' Equity.

On October 12, 2010, we entered into a second Securities Purchase Agreement with PharmaBio pursuant to which PharmaBio agreed to purchase 2,380,952 shares of our common stock and warrants to purchase an aggregate of 1,190,476 shares of common stock, sold as units consisting of one share of common stock and one warrant to purchase one-half of a share of common stock, at an offering price of $0.21 per unit, resulting in gross proceeds to us of $500,000. The warrants generally will expire in October 2015 and are immediately exercisable for cash (except in certain limited circumstances), subject to an aggregate beneficial ownership limitation of 9.99%, at an exercise price per share of $0.273 per share and, if exercised in full, would result in additional proceeds to us of approximately $0.325 million. In addition, we may redeem any or all of the warrants at any time within 20 days following the occurrence of a "trading threshold" (as defined in the warrant agreement) at a per-warrant redemption price of $0.001, upon 20 days' written notice to the holder of the warrant. *See*, Note 5 – Stockholders' Equity – Common Stock Offerings with PharmaBio Development Inc.

As of September 30, 2010, we had cash and cash equivalents of $14.7 million, which includes net proceeds of $0.6 million in September 2010 from the first of two settlements from a September 2010 draw down on our 2010 CEFF. We will require additional capital to support our ongoing development activities through the potential approval of Surfaxin in 2011, including activities to advance Surfaxin LS and Aerosurf to our planned Phase 3 and Phase 2 clinical trials. We recently received payment of a non-dilutive grant under the Patient Protection and Affordable Care Act of 2010 in the amount of approximately $0.25 million to support our activities related to Aerosurf. In addition, our 2010 CEFF, subject to certain conditions that we must meet, may allow us to raise additional capital, although there can be no assurance that the CEFF will be available, and if the CEFF is available at any time, that we will be able to raise sufficient capital when needed. As of November 12, 2010, our December 2008 CEFF and the May 2008 CEFF were not available because the closing market price of our common stock on that date ($0.21) was below the minimum price required ($0.60 and $1.15, respectively) to utilize those facilities. *See*, Note 5 – Stockholders' Equity, for details regarding our CEFFs.

Note 4 – Accounting Policies and Recent Accounting Pronouncements

Accounting policies

There have been no changes to our critical accounting policies since December 31, 2009. For more information on critical accounting policies, *see*, Note 4 – "Summary of Significant Accounting Policies and Recent Accounting Pronouncements" to the consolidated financial statements included in our 2009 Annual Report on Form 10-K. Readers are encouraged to review those disclosures in conjunction with the review of this Quarterly Report on Form 10-Q.

Net loss per common share

Basic net loss per common share is computed by dividing the net loss by the weighted average number of common shares outstanding for the periods. As of September 30, 2010 and 2009, 78.4 million and 30.9 million shares of common stock, respectively, were potentially issuable upon the exercise of certain stock options and warrants. Due to our net loss, these potentially issuable shares were not included in the calculation of diluted net loss per share as the effect would be anti-dilutive, therefore basic and dilutive net loss per share are the same.

Comprehensive loss

Comprehensive loss consists of net loss plus the changes in unrealized gains and losses on available-for-sale securities. Comprehensive loss for the three and nine months ended September 30, 2010 and 2009 are as follows:

(in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2010	**2009** (As Restated)	**2010**	**2009** (As Restated)
Net loss	$ (6,584)	$ (8,853)	$ (13,435)	$ (27,084)
Change in unrealized (losses)/gains on marketable securities	–	–	-	(1)
Comprehensive loss	$ (6,584)	$ (8,853)	$ (13,435)	$ (27,085)

Recent accounting pronouncements

In March 2010, Accounting Standards Update (ASU) 2010-17, *Revenue Recognition—Milestone Method* (Topic 605)*: Milestone Method of Revenue Recognition—a consensus of the FASB Emerging Issues Task Force* (ASU 2010-17) was issued and will amend the accounting for revenue arrangements under which a vendor satisfies its performance obligations to a customer over a period of time, when the deliverable or unit of accounting is not within the scope of other authoritative literature, and when the arrangement consideration is contingent upon the achievement of a milestone. The amendment defines a milestone and clarifies whether an entity may recognize consideration earned from the achievement of a milestone in the period in which the milestone is achieved. This amendment is effective for fiscal years beginning on or after June 15, 2010, with early adoption permitted. The amendment may be applied retrospectively to all arrangements or prospectively for milestones achieved after the effective date. We do not believe the adoption of this ASU will have a material impact on our financial statements.

Note 5 – Stockholders' Equity

Registered Public Offerings

On June 22, 2010, we completed a public offering of 35.7 million shares of our common stock, five-year warrants to purchase 17.9 million shares of our common stock (Five-Year Warrants), and short-term (nine month) warrants to purchase 17.9 million shares of our common stock (Short-Term Warrants). The securities were sold as units, with each unit consisting of one share of common stock, a Five-Year Warrant to purchase one half share of common stock, and a Short-Term Warrant to purchase one half share of common stock, at a public offering price of $0.28 per unit, resulting in gross proceeds to us of $10 million ($9.1 million net). The Five-Year Warrants expire on June 22, 2015 and are exercisable, subject to an aggregate beneficial ownership limitation, at a price per share of $0.40. The Short-Term Warrants expire on March 22, 2011 and are exercisable, subject to an aggregate beneficial ownership limitation, at a price per share of $0.28. The exercise price and number of shares of common stock issuable on exercise of the warrants are subject to adjustment in the event of any stock split, reverse stock split, stock dividend, recapitalization, reorganization or similar transaction, among other events as described in the warrants. The exercise price and the amount and/or type of property to be issued upon exercise of the warrants are also subject to adjustment if we engage in a "Fundamental Transaction" (as defined in the form of warrant). The warrants are exercisable for cash only, except that if the related registration statement or an exemption from registration is not otherwise available for the resale of the warrant shares, the holder may exercise on a cashless basis. This offering was made pursuant to our 2008 Shelf Registration Statement.

In February 2010, we completed a public offering of 27.5 million shares of our common stock and warrants to purchase 13.8 million shares of our common stock, sold as units, with each unit consisting of one share of common stock and a warrant to purchase one half share of common stock, at a public offering price of $0.60 per unit, resulting in gross proceeds to us of $16.5 million ($15.1 million net). The warrants expire in February 2015 and are exercisable, subject to an aggregate beneficial ownership limitation, at a price per share of $0.85. The exercise price and number of shares of common stock issuable on exercise of the warrants will be subject to adjustment in the event of any stock split, reverse stock split, stock dividend, recapitalization, reorganization or similar transaction. The exercise price and the amount and/or type of property to be issued upon exercise of the warrants will also be subject to adjustment if we engage in a "Fundamental Transaction" (as defined in the form of warrant). The warrants are exercisable for cash only, except that if the related registration statement or an exemption from registration is not otherwise available for the resale of the warrant shares, the holder may exercise on a cashless basis. This offering was made pursuant to our 2008 Shelf Registration Statement.

In May 2009, we completed a registered direct offering of 14.0 million shares of our common stock and warrants to purchase seven million shares of common stock, sold as units to select institutional investors, with each unit consisting of one share and a warrant to purchase one half share of common stock, at a price of $0.81 per unit, resulting in gross proceeds to us of $11.3 million ($10.5 million net). The warrants expire in May 2014 and are exercisable at a price per share of $1.15. The exercise price and number of shares of common stock issuable on exercise of the warrants will be subject to adjustment in the event of any stock split, reverse stock split, stock dividend, recapitalization, reorganization or similar transaction. The exercise price and the amount and/or type of property to be issued upon exercise of the warrants will also be subject to adjustment if we engage in a "Fundamental Transaction" (as defined in the form of warrant). The warrants are exercisable for cash only, except that if the related registration statement or an exemption from registration is not otherwise available for the resale of the warrant shares, the holder may exercise on a cashless basis. This offering was made pursuant to our 2008 Shelf Registration Statement.

Common Stock Offerings with PharmaBio Development Inc.

On April 27, 2010, we entered into a Securities Purchase Agreement with PharmaBio, as the sole purchaser, related to an offering of 4,052,312 shares of common stock and warrants to purchase an aggregate of 2,026,156 shares of common stock, sold as units with each unit consisting of one share of common stock and a warrant to purchase one half share of common stock, at an offering price of $0.5429 per unit, representing the greater of (a) the volume-weighted average price per share of our common stock (VWAP) on The Nasdaq Global Market for the 20 trading days ending on April 27, 2010 and (b) the last reported closing price of $0.5205 per share of the common stock on The Nasdaq Global Market on that date. The offering resulted in gross proceeds to us of $2.2 million ($2.1 million net). The warrants expire in April 2015 and generally will be exercisable beginning on October 28, 2010, subject to an aggregate beneficial ownership limitation of 9.9%, at a price per share of $0.7058, which represents a 30% premium to the VWAP for the 20 trading days ending on April 27, 2010. The exercise price and number of shares of common stock issuable on exercise of the warrants will be subject to adjustment in the event of any stock split, reverse stock split, stock dividend, recapitalization, reorganization or similar transaction. The exercise price and the amount and/or type of property to be issued upon exercise of the warrants will also be subject to adjustment if we engage in a "Fundamental Transaction" (as defined in the form of warrant). The warrants are exercisable for cash only, except that if the related registration statement or an exemption from registration is not otherwise available for the resale of the warrant shares, the holder may exercise on a cashless basis. The offering closed on April 30, 2010. The shares of common stock and the shares of common stock to be issued upon exercise of the warrants were offered pursuant to our 2008 Shelf Registration Statement.

On October 12, 2010, we entered into a second Securities Purchase Agreement with PharmaBio, as the sole purchaser, pursuant to which PharmaBio agreed to purchase 2,380,952 shares of our common stock and warrants to purchase an aggregate of 1,190,476 shares of common stock, sold as units consisting of one share of common stock and one warrant to purchase one-half of a share of common stock, at an offering price of $0.21 per unit, representing, the greater of (a) the VWAP on the Nasdaq Capital Market for 10 consecutive trading days ending on October 11, 2010 and (b) the VWAP on October 11, 2010. This offering was made pursuant to our 2008 Shelf Registration Statement and resulted in gross proceeds to us of $0.50 million. The warrants generally will expire in October 2015 and are immediately exercisable, subject to an aggregate beneficial ownership limitation of 9.99%, at an exercise price per share of $0.273 per share and, if exercised in full, would result in additional proceeds to us of approximately $0.325 million. The warrants are exercisable for cash only, except that if the related registration statement or an exemption from registration is not otherwise available for the sale of the warrant shares, the holder may exercise on a cashless basis. In addition, upon 20 days' written notice to the holder of the warrant, we may redeem any or all of the warrants at any time within 20 days following the occurrence of a "trading threshold" (as defined below) at a per-warrant share redemption price of $0.001. All warrants noticed for redemption that have not been exercised by the holder prior of expiration of the notice period (as it may be extended if the registration statement is not effective), will, upon payment by us of the aggregate redemption price, cease to represent the right to purchase any shares of our common stock and will be deemed cancelled and void for all purposes. A "trading threshold" will be deemed to have occurred on any date that the reported VWAP for five of the immediately preceding seven consecutive trading days exceeds $0.45, provided that the minimum average daily trading volume of our common stock during the seven-day period is at least 500,000 shares (the price and volume criteria being adjusted to take into account any share dividend, share split or other similar transaction that may occur on or after the issuance).

Committed Equity Financing Facilities (CEFFs)

As of September 30, 2010, we had three CEFFs with Kingsbridge Capital Limited (Kingsbridge), under which Kingsbridge is committed to purchase, subject to certain conditions, newly-issued shares of our common stock. The CEFFs, dated June 11, 2010 (2010 CEFF), December 12, 2008 (December 2008 CEFF) and May 22, 2008 (May 2008 CEFF), allow us at our discretion to raise capital for a period of three years ending June 11, 2013, June 18, 2011, and February 6, 2011, respectively, at the time and in amounts deemed suitable to us. We are not obligated to utilize any of the funds available under the CEFFs. Our ability to access funds available under the CEFFs is subject to certain conditions, including stock price and volume limitations.

As of September 30, 2010, under the 2010 CEFF, we had approximately 28.5 million shares potentially available for issuance (up to a maximum of $34.4 million), provided that the VWAP on each trading day must be at least equal to the greater of $0.20 or 90% of the closing market price on the day preceding the first day of draw down (Minimum VWAP). Under the December 2008 CEFF, we had 7.1 million shares potentially available for issuance (up to a maximum of $17.7 million), provided that the VWAP on each trading day during the draw-down period must be at least equal to the greater of $.60 or the Minimum VWAP Under the May 2008 CEFF, we had approximately 12.8 million shares potentially available for issuance (up to a maximum of $51.7 million), provided that the VWAP on each trading day must be at least equal to the greater of $1.15 or the Minimum VWAP. Use of each CEFF is subject to certain other covenants and conditions, including aggregate share and dollar limitations for each draw down. *See*, our 2009 Form 10-K – "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Committed Equity Financing Facilities (CEFFs)" and, for a detailed description of our 2010 CEFF, our Quarterly Report on Form 10-Q, for the period ending June 30, 2010 – Note 5 – Committed Equity Financing Facilities (CEFFs) – 2010 CEFF. We anticipate using our CEFFs (at such times as our stock price is at least equal to the minimum price requirement) to support our working capital needs and maintain cash availability in 2010.

On October 4, 2010, we completed a financing under our 2010 CEFF resulting in gross proceeds of approximately $1.0 million from the issuance of 5,272,361 shares of our common stock at an average price per share, after applicable fees and discounts, of $0.18. The settlement dates for this draw down were September 28, 2010 and October 4, 2010, respectively.

On November 9, 2010, we completed a financing under our 2010 CEFF resulting in gross proceeds of approximately $.36 million from the issuance of 2,488,218 shares of our common stock at an average price per share, after applicable fees and discounts, of $0.17. The settlement dates for this draw down were November 4, 2010 and November 9, 2010.

As of November 12, 2010, the 2010 CEFF was available, subject to certain conditions that we must meet, but the December 2008 CEFF and the May 2008 CEFF were not available because the closing market price of our common stock on that date ($0.21) was below the minimum price required ($0.60 and $1.15, respectively) to utilize those facilities.

During 2009, we raised an aggregate of $10.7 million from 10 draw-downs under our CEFFs.

Note 5 – Fair Value of Financial Instruments

We adopted the provisions of Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value under GAAP and enhances disclosures about fair value measurements.

Under ASC Topic 820, fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The fair value hierarchy is based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value which are the following:

- Level 1 – Quoted prices in active markets for identical assets and liabilities. Level 1 is generally considered the most reliable measurement of fair value under ASC 820.

- Level 2 – Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

- Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Fair Value on a Recurring Basis

The table below categorizes assets and liabilities measured at fair value on a recurring basis as of September 30, 2010:

	Fair Value	Fair value measurement using		
Assets:	September 30, 2010	Level 1	Level 2	Level 3
Money Markets and Certificates of Deposit	$ 12,390	$ 12,390	$ –	$ –
Restricted Cash	400	400	–	–
Total Assets	$ 12,790	$ 12,790	$ –	$ –
Liabilities:				
Common stock warrant liability	$ 2,508	$ –	$ –	$ 2,508

The following table summarizes the activity of Level 3 inputs measured on a recurring basis for the quarter ended September 30, 2010:

(in thousands)	Fair Value Measurements of Common Stock Warrants Using Significant Unobservable Inputs (Level 3)
Balance at June 30, 2010	$ 2,143
Issuance of common stock warrants	-
Change in fair value of common stock warrant liability	365
Balance at September 30, 2010	$ 2,508

Note 7 – Stock Options and Stock-Based Employee Compensation

We recognize all share-based payments to employees and non-employee directors in our financial statements based on their grant date fair values, calculated using the Black-Scholes option pricing model. Compensation expense related to share-based awards is recognized ratably over the requisite service period, typically three years for employees.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing formula that uses weighted average assumptions noted in the following table.

	September 30, 2010	September 30, 2009
Expected volatility	99%	81%
Expected term	4.7 years	4.6 years
Risk-free interest rate	1.7%	2.1%
Expected dividends	–	–

The total employee stock-based compensation for the three and nine months ended September 30, 2010 and 2009 was as follows:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Research & Development	$ 73	$ 61	$ 367	$ 512
General & Administrative	175	145	684	1,540
Total	$ 248	$ 206	$ 1,051	$ 2,052

As of September 30, 2010, there was $1.2 million of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under the Amended and Restated 1998 Stock Incentive Plan and the 2007 Long-Term Incentive Plan. That cost is expected to be recognized over a weighted-average vesting period of 0.8 years.

Note 8 – Contractual Obligations and Commitments

Former CEO Commitment

In connection with the resignation in August 2009 of Robert J. Capetola, Ph.D., our former President, Chief Executive Officer and member of our Board, we entered into a separation agreement and general release (Separation Agreement) dated August 13, 2009, that provided, among other things, for periodic severance payments through the earlier of (i) May 3, 2010 (Severance Period) or (ii) the date, if ever, of a Corporate Transaction (defined below). Under the Separation Agreement, if a "Corporate Transaction" not involving a change of control were to occur during the Severance Period, Dr. Capetola would become entitled to receive an additional severance payment of up to $1,580,000, reduced by the sum of the aggregate cash severance amounts already paid under the Separation Agreement. A "Corporate Transaction" was defined to include one or more public or private financings completed during the Severance Period and resulting in cash proceeds (net of transaction costs) to us of at least $20 million. From August 13, 2009 through February 23, 2010, we raised approximately $21.0 million of aggregate net proceeds, including approximately $5.9 million from financings under our CEFFs and $15.1 million from a public offering that was completed on February 23, 2010. Accordingly, on March 3, 2010, we paid to Dr. Capetola an additional $1.06 million (less withholding), representing $1.58 million reduced by the sum of the cash severance amounts previously paid under the Separation Agreement, which totaled approximately $0.52 million. At this time, our obligation to make periodic payments under the Separation Agreement has been satisfied and no further payments are due to Dr. Capetola.

The full text of the Separation Agreement is attached to our Current Report on Form 8-K that we filed with the SEC on August 19, 2009. For a summary of the Separation Agreement, *see*, "Item 11– Executive Compensation –Resignation of our President and Chief Executive Officer," in our Amendment No. 1 to our 2009 Form 10-K that we filed with the SEC on April 30, 2010 (2009 Form 10-K/A-1).

Note 9 – Subsequent Events

We evaluated all events or transactions that occurred after September 30, 2010 up through November 15, 2010, the date we issued these financial statements. During this period we did not have any material recognized subsequent events, however, there were three nonrecognized subsequent events described below:

On October 4, 2010, we completed a financing under the 2010 CEFF resulting in gross proceeds of approximately $1.0 million from the issuance of 5,272,361 shares of our common stock at an average price per share, after the applicable fees and discount, of $0.18. The settlement dates for this draw down were September 28, 2010 and October 4, 2010, respectively. (*See* Note 5 - Stockholders' Equity)

On October 12, 2010, we entered into a Securities Purchase Agreement with PharmaBio related to the offering of 2,380,952 shares of common stock and warrants to purchase an aggregate of 1,190,476 shares of common stock. The offering resulted in net proceeds to us of $0.5 million. (*See* Note 5 - Stockholders' Equity)

On October 15, 2010, our Board appointed W. Thomas Amick, Chairman of our Board, as our full-time Chief Executive Officer effective October 18, 2010. As of October 18, 2010, we entered into an employment agreement with Mr. Amick, under which he will receive: a base salary of at least $400,000 per year and a discretionary annual bonus opportunity in the form of either cash or equity, or both, subject to the discretion of the Compensation Committee of the Board. In addition, on October 18, 2010, Mr. Amick was granted 400,000 restricted shares of our common stock (the "RSAs"). The RSAs will vest on the earliest to occur of the following: (i) the second anniversary of the date of grant; (ii) the date of issuance by FDA of marketing approval for Surfaxin® for the prevention of respiratory distress syndrome (RDS) in premature infants; and (iii) the effective date of a strategic alliance, collaboration agreement or other similar arrangement between us and one or more third parties providing for the support for the development and/or commercialization of one or more of our lead research and development programs – Surfaxin, Surfaxin LS™ or Aerosurf® (whether a transaction meets this requirement shall be determined by the Board in its sole discretion). The RSAs will vest only if Mr. Amick is actively providing services to the Company on the day of vesting. *See,* "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Debt – Contractual Obligations and Commitments."

On November 9, 2010, we completed a financing under our 2010 CEFF resulting in gross proceeds of approximately $.36 million from the issuance of 2,488,218 shares of our common stock at an average price per share, after applicable fees and discounts, of $0.17. The settlement dates for this draw down were November 4, 2010 and November 9, 2010. (*See* Note 5 - Stockholders' Equity)

ITEM 1. BUSINESS – Business Operations.

Strategic Alliances and Technology License Agreements

Laboratorios del Dr. Esteve, S.A.

We have a strategic alliance with Laboratorios del Dr. Esteve, S.A. (Esteve) for the development, marketing and sales of a broad portfolio of potential KL4 surfactant products in Andorra, Greece, Italy, Portugal, and Spain. Esteve will pay us a transfer price on sales of Surfaxin and other KL4 surfactant products. We will be responsible for the manufacture and supply of all of the covered products and Esteve will be responsible for all sales and marketing in the territory. Esteve is obligated to make stipulated cash payments to us of up to $5.1 million in the aggregate upon our achievement of certain milestones, primarily upon receipt of marketing regulatory approvals for the covered products. In addition, Esteve has agreed to contribute to Phase 3 clinical trials for the covered products by conducting and funding development performed in the territory. As part of a restructuring of this alliance in December 2004, we regained full commercialization rights to our KL4 surfactant technology in portions of the original territory licensed to Esteve, including key European markets, Central America, and South America (Former Esteve Territories) and agreed to pay to Esteve 10% of any cash up-front and milestone fees (not to exceed $20 million in the aggregate) that we may receive in connection with any strategic collaborations for the development and/or commercialization of certain of our KL4 surfactant products, including Surfaxin and Aerosurf in the Former Esteve Territories. The alliance will terminate as to each covered product, on a country-by-country basis, upon the latest to occur of: the expiration of last patent claim related to a covered product in such country; the first commercial sale in such country of the first-to-appear generic formulation of the covered product, and the tenth anniversary of the first sale of the covered product in such country. In addition to customary termination provisions for breach of the agreement by a party, the alliance agreement may be terminated by Esteve on 60 days' prior written notice, up to the date of receipt of the first marketing regulatory approval, or, on up to 6 months' written notice, if the first marketing regulatory approval has issued. We may terminate the alliance agreement in the event that Esteve acquires a competitive product (as defined in the agreement).

Johnson & Johnson, Ortho Pharmaceutical Corporation and The Scripps Research Institute

Our precision-engineered surfactant platform technology, including Surfaxin, is based on the proprietary synthetic peptide, KL_4 (sinapultide), a 21 amino acid protein-like substance that closely mimics the essential human lung protein SP-B. This technology was invented at The Scripps Research Institute (Scripps) and was exclusively licensed to and further developed by Johnson & Johnson (J&J). We have received an exclusive, worldwide license and sublicense from J&J and its wholly-owned subsidiary, Ortho Pharmaceutical Corporation, for, and have rights to, a series of over 30 patents and patent filings (worldwide) which are important, either individually or collectively, to our strategy for commercializing our precision-engineered surfactant technology for the diagnosis, prevention and treatment of disease. The license and sublicense give us the exclusive rights to such patents for the life of the patents. Under the license agreement, we are obligated to pay licensors fees of up to $2.5 million in the aggregate upon our achievement of certain milestones, primarily upon receipt of marketing regulatory approvals for certain designated products. In addition, we are required to make royalty payments at different rates, depending upon type of revenue and country, in amounts of up to a high single-digit percent of net sales (as defined in the agreement) of licensed products sold by us or sublicensees, or, if greater, a percentage of royalty income from sublicensees in the low double digits. The license agreement will expire, on a country-by-country, upon expiration of the last patent containing a valid claim covering a licensed product in such country. In addition to customary termination provisions for breach of the agreement by a party, we may terminate the agreement, as to countries other than the U.S. and Western Europe territories (as defined in the agreement), on a country-by-country basis, on 6 months' prior written notice; and as to the entire agreement, on 60 days' prior written notice.

Philip Morris USA Inc. and Philip Morris Products S.A.

In March 2008, we restructured our December 2005 strategic alliance with Philip Morris USA Inc. (PMUSA), d/b/a Chrysalis Technologies (Chrysalis), and assumed full responsibility from Chrysalis for the further development of the capillary aerosolization technology, including finalizing design development for the initial prototype aerosolization device platform and disposable dose packets. In connection with the restructuring, we restated our prior agreement as of March 28, 2008 and entered into an Amended and Restated License Agreement with PMUSA with respect to the United States (U.S. License Agreement), and, as PMUSA had assigned to Philip Morris Products S.A. (PMPSA) all rights in and to the capillary aerosolization technology outside of the United States (International Rights), effective on the same date, we entered into a License Agreement with PMPSA with respect to the International Rights (International License Agreement) on substantially the same terms and conditions as the U.S. License Agreement. We currently hold exclusive licenses to the capillary aerosolization technology both in and outside of the United States for use with pulmonary surfactants (alone or in combination with any other pharmaceutical compound(s)) for all respiratory diseases and conditions (the foregoing uses in each territory, the Exclusive Field). In addition, under the U.S. License Agreement, our license to use the capillary aerosolization technology includes other (non-surfactant) drugs to treat a wide range of pediatric and adult respiratory indications in hospitals and other health care institutions. Each License Agreement, unless terminated earlier will expire as to each licensed product, on a country-by-country basis, upon the latest to occur of: the date on which the sale of such licensed product ceases to be covered by a patent claim of an issued and unexpired patent in such country; the date a generic form of the product is introduced in such country; and the tenth anniversary of the tenth anniversary of the first commercial sale of such licensed product. In addition to customary termination provisions for breach of the agreements, we may terminate the License Agreements, in whole or in part, upon advance written notice to the licensor. In addition, either party to each License Agreement may terminate upon a material breach by the other party (subject to a specified cure period).

As part of the restructuring, Chrysalis completed a technology transfer, provided development support to us through June 30, 2008, and also paid us $4.5 million to support our future development activities. We are obligated to pay royalties at a rate equal to a low single-digit percent of sales of products sold in the Exclusive Field in the territories. In connection with exclusive undertakings of PMUSA and PMPSA not to exploit the capillary aerosolization technology for all licensed uses, we are obligated to pay royalties on all product sales, including sales of aerosol devices and related components that are not based on the capillary aerosolization technology; provided, however, that no royalties are payable to the extent that we exercise our right to terminate the license with respect to a specific indication. We also agreed in the future to pay minimum royalties, but are entitled to a reduction of future royalties in the amount of any minimum royalties paid.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is provided as a supplement to the accompanying interim unaudited consolidated financial statements and footnotes to help provide an understanding of our financial condition, the changes in our financial condition and our results of operations. This item should be read in connection with our accompanying interim unaudited consolidated financial statements (including the notes thereto) appearing elsewhere herein.

Restatement of Previously Filed Financial Statements

On November 12, 2010, we filed with the SEC (i) Amendment No. 2 to our Annual Report on Form 10-K for the year ended December 31, 2009 (Amendment No. 2) and (ii) Amendment No. 1 to each of our Quarterly Reports on Form 10-Q for the periods ended March 31, 2010 and June 30, 2010, to restate our consolidated balance sheets, consolidated statement of operations and statements of cash flows for the applicable periods to reclassify certain registered warrants based on a reassessment of applicable accounting guidance. As reported in Amendment No. 2, the restatements reclassify as derivative liabilities certain registered warrants that we issued in May 2009 and February 2010, which were recorded as equity, with such liabilities measured at fair value on the date of issue using the Black-Scholes option pricing model, with subsequent changes in the fair values recognized in our quarterly statement of operations as "Change in fair value of common stock warrant liability." The amounts presented in this Quarterly Report on Form 10-Q reflect the reclassification of the warrants identified above. The restatements have had no impact on amounts previously reported for Assets; Revenues; Operating Expenses; Cash Flows; Loans, Equipment Loan and Accounts Payables; and Contractual Obligations. References in this MD&A and elsewhere in this Quarterly Report on Form 10-Q to our 2009 Form 10-K and our Quarterly Reports on Form 10-Q for the periods ended March 31, 2010 and June 30, 2010 are intended to refer to those reports as amended by the foregoing Amendments.

OVERVIEW

Discovery Laboratories, Inc. (referred to as "we," "us," or the "Company") is a biotechnology company developing surfactant therapies to treat respiratory disorders and diseases for which there frequently are few or no approved therapies. Our novel KL_4 proprietary technology produces a synthetic, peptide-containing surfactant (KL_4 surfactant) that is structurally similar to pulmonary surfactant, a substance produced naturally in the lung and essential for survival and normal respiratory function. In addition, our proprietary capillary aerosol-generating technology (capillary aerosolization technology) produces a dense aerosol with a defined particle size, to potentially deliver our aerosolized KL_4 surfactant to the lung. As many respiratory disorders are associated with surfactant deficiency or surfactant degradation, we believe that our proprietary technology platform makes it possible, for the first time, to develop a significant pipeline of surfactant products targeted to treat a wide range of previously unaddressed respiratory problems.

We are developing our lead products, Surfaxin® (lucinactant), Surfaxin LS™ and Aerosurf®, to address the most significant respiratory conditions affecting pediatric populations. Our research and development efforts are currently focused on the management of RDS in premature infants. We filed a New Drug Application (NDA) for our first product based on our novel KL_4 surfactant technology, Surfaxin for the prevention of respiratory distress syndrome (RDS) in premature infants, and received a Complete Response Letter from the U.S. Food and Drug Administration (FDA) in April 2009. We believe that the RDS market represents a significant opportunity from both a medical and a business perspective and that Surfaxin, Surfaxin LS and Aerosurf have the potential to greatly improve the management of RDS. We also believe that Surfaxin, Surfaxin LS and Aerosurf collectively represent an opportunity, over time, to significantly expand the current RDS worldwide annual market. *See*, "– Business and KL_4 Pipeline Programs Update," below.

In addition to our lead products, we plan over time to develop our KL_4 surfactant technology into a broad product pipeline that potentially will address a variety of debilitating respiratory conditions for which there currently are no or few approved therapies, in patient populations ranging from premature infants to adults. We are conducting early stage research and development with our KL_4 surfactant potentially to address critical care respiratory conditions such as Acute Respiratory Failure (ARF) and Acute Lung Injury (ALI), and, respiratory diseases associated with mucociliary compromise, such as Cystic Fibrosis(CF). We plan to initially develop these programs through a proof-of-concept phase and, if successful, thereafter determine whether to seek strategic alliances or collaboration arrangements or utilize other financial alternatives to fund their further development and/or worldwide commercialization, if approved. There can be no assurance that we will succeed in demonstrating proof of concept or entering into any such alliance, however.

An important priority is to secure strategic and financial resources to potentially maximize the inherent value of our KL_4 surfactant technology. We prefer to accomplish our objectives through strategic alliances, including potential business alliances, and commercial and development partnerships. To advance the development of our lead products, we are engaged in discussions with potential strategic and/or financial partners. In addition, our plans include potentially taking our early stage exploratory programs through a Phase 2 proof-of-concept phase and, if successful, thereafter determining whether to seek strategic alliances or collaboration arrangements or to utilize other financial alternatives to fund their further development. To secure required capital, we are also considering other alternatives, including additional financings and other similar opportunities. Although we continue to evaluate potential strategic and financial alternatives, there can be no assurance that we will enter into any strategic alliance or otherwise consummate any financing or other similar transaction.

We have focused our current resources on our lead products, primarily to address the requirements to gain the potential approval of Surfaxin for the prevention of RDS in the United States. Until such time as we secure sufficient strategic and financial resources to support the continuing development of our KL_4 surfactant technology and support our operations, we will continue to conserve our resources, predominantly by curtailing and pacing investments in our pipeline programs.

Business and KL_4 Pipeline Programs Update

The reader is referred to, and encouraged to read in its entirety "Item 1 – Business" in our Annual Report on Form 10-K for the year ended December 31, 2009 that we filed with the Securities and Exchange Commission (SEC) on March 10, 2010 (2009 Form 10-K), which contains a discussion of our Business and Business Strategy, as well as information concerning our proprietary technologies and our current and planned KL_4 pipeline programs.

The following are updates to our pipeline programs:

- Surfaxin for the Prevention of RDS in Premature Infants

  We received a Complete Response Letter from the FDA in April 2009. The letter focused primarily on certain aspects of our fetal rabbit biological activity test (BAT, a quality control, release and stability test for Surfaxin and our other KL_4 pipeline products), specifically whether analysis of data from both the BAT and a well-established preterm lamb model of RDS demonstrates the degree of comparability that the FDA requires and whether the BAT can adequately distinguish change in Surfaxin biological activity over time. We believe that satisfying the FDA as to the final validation of the BAT is a key remaining chemistry, manufacturing & control (CMC) step necessary to potentially gain FDA marketing approval for Surfaxin for the prevention of RDS ..

  In this respect, we conducted a comprehensive preclinical program intended to satisfy the FDA. The comprehensive preclinical program, as proposed to the FDA, involved the optimization and subsequent revalidation of the BAT, which was then employed in a series of prospectively-designed, side-by-side preclinical studies with the well-established preterm lamb model of RDS. We have taken into account the FDA's guidance in conducting our comprehensive program. These proposed studies were recently completed. The resulting dataset is undergoing final review and compilation in preparation for submission to the FDA.

  Throughout this process, we have had multiple interactions with the FDA intended to ensure that the comprehensive preclinical program satisfies the FDA as to the final validation of the BAT and its ultimate appropriateness as a release and stability test for Surfaxin, upon potential approval. Previously, we provided additional analysis to the FDA regarding the revalidation of the BAT intended to aid the FDA in its final determination of whether the BAT is appropriately validated for use as an ongoing quality control release and stability test for Surfaxin, if approved. We are awaiting FDA feedback regarding this analysis and anticipate further interactions in advance of the pending complete response. Such interactions with the FDA could affect the ultimate timing, conduct and outcomes of remaining steps necessary to gain Surfaxin approval, including the potential filing of the complete response. We believe we remain on track to submit a complete response to the FDA in the first quarter of 2011, potentially leading to Surfaxin approval later in the year. If approved, Surfaxin would become the first synthetic, peptide-containing surfactant for commercial use in neonatal medicine.

- Surfaxin LS and Aerosurf Development Programs

We are conducting important preclinical activities for both Surfaxin LS and Aerosurf to support regulatory requirements for our planned clinical programs. We intend to initiate these clinical programs upon determining a final regulatory strategy and after securing appropriate strategic alliances and necessary capital.

  - Surfaxin LS, our lyophilized KL_4 surfactant, is a dry powder formulation that is resuspended as a liquid prior to use. Surfaxin LS is intended to further improve on the Surfaxin product profile and provide access to international markets. We plan to seek regulatory guidance regarding our planned Phase 3 clinical program, with the FDA in the fourth quarter 2010 and with the EMA in early 2011. In support of our planned development and regulatory program for Surfaxin LS, we have contracted with a leading pharmaceutical contract manufacturing organization that has significant lyophilization capital equipment and expertise to establish a Surfaxin LS clinical supply manufacturing capability that is compliant with current good manufacturing practices (cGMP). We are currently completing the development of our clinical manufacturing process, which includes the conduct of key CMC activities in preparation for the potential manufacture of process validation batches of lyophilized KL_4 surfactant in the fourth quarter of 2010.

  - Aerosurf is our novel drug/device combination therapy that, if approved, will enable the early administration of aerosolized surfactant to address neonatal RDS. Aerosurf holds the promise to significantly expand the use of surfactant therapy by providing neonatologists with a less invasive means of delivering KL4 surfactant without the current requirement of invasive endotracheal intubation and mechanical ventilation. We plan to seek regulatory guidance concerning our planned Phase 2 clinical programs with both FDA and the EMA in the first half of 2011. We are also working with a leading technology company with expertise in biomedical device development to optimize the design of our capillary aerosolization device to potentially satisfy regulatory and development requirements for our Aerosurf clinical development programs.

- Acute Respiratory Failure / Acute Lung Injury Program

We recently completed our analysis of data from our Phase 2 clinical trial of Surfaxin to potentially address Acute Respiratory Failure (ARF). ARF is a severe respiratory disorder associated with lung injury, often involving surfactant dysfunction. ARF occurs after patients have been exposed to serious respiratory infections, such as influenza (including the type A serotype referred to as H1N1) or respiratory syncytial virus (RSV). The study was a multicenter, randomized, masked trial that enrolled 165 children under the age of two and compared Surfaxin treatment to standard of care alone. The objective was to evaluate the safety and tolerability of intratracheal administration of Surfaxin and to assess whether Surfaxin treatment could decrease the duration of mechanical ventilation in children with ARF. The reported preliminary results of this trial indicate that (i) Surfaxin treatment was generally safe and well tolerated in the designated patient population, and (ii) Surfaxin treatment reduced time on mechanical ventilation by approximately 10% compared with standard of care alone, although this observation was not statistically significantly. We recently completed further analyses of the trial data and found that (a) based on patient stratification by severity of lung injury, Surfaxin treatment significantly reduced time on mechanical ventilation in the least severe patient segment ($p < 0.01$), and (b) Surfaxin treatment reduced the need for a second surfactant dose ($p < 0.05$), suggesting a decrease in disease severity following surfactant treatment. Our analyses of the ARF trial data has been submitted for presentation at medical congresses in 2011.

Data from this trial are supportive of our belief that intervention with aerosolized KL_4 surfactant earlier in the disease progression may provide for a better clinical outcome in patients at risk for severe respiratory compromise. As a next step in development, we have entered into a collaboration with a leading academic center to evaluate the potential advantage of aerosolized KL_4 surfactant intervention in a pre-clinical model of acute lung injury and expects this study to conclude in early 2011.

- Cystic Fibrosis / Mucociliary Clearance Program

  Our aerosolized KL_4 surfactant has been evaluated in a recently completed investigator-initiated Phase 2a clinical trial in Cystic Fibrosis (CF) patients. The trial was conducted at a leading research center, The University of North Carolina, and was funded by the Cystic Fibrosis Foundation Therapeutics, Inc., a nonprofit affiliate of the Cystic Fibrosis Foundation. The results of this trial were presented at the 2010 North American Cystic Fibrosis Conference by Dr. Scott H. Donaldson (University of North Carolina), the study's principle investigator. The study was a double-blind, randomized crossover Phase 2a study to evaluate whether our aerosolized KL_4 surfactant, delivered by an investigational eFlow Nebulizer System (PARI Pharma GmbH. Munich, Germany), is safe and well tolerated in patients with mild to moderate CF lung disease, compared with the active comparator, aerosolized saline control. The results demonstrate that (a) delivery of aerosolized KL_4 surfactant delivery to CF patients appears feasible, (b) our KL_4 surfactant was generally safe and well tolerated and not associated with serious adverse events, and (c) produced a marked, significant ($p < 0.01$) increase from patient baseline in mucociliary clearance (MCC) measured one hour after the last dose in both whole lung and peripheral lung compartments; however, this effect was not different when compared to the active comparator control group at this time point. This study assessed aerosolized KL_4 surfactant in an ambulatory setting and supports a rationale for further development of our aerosolized KL_4 surfactant in CF and other diseases associated with mucociliary compromise.

  Additionally, the Office of Orphan Products Development of the FDA granted orphan drug designation to our KL_4 surfactant for the treatment of CF. Orphan designation provides a designated indication with up to seven years of U.S. market drug product exclusivity following marketing approval.

As of September 30, 2010, we had cash and cash equivalents of $14.7 million.

We will require additional capital to support our ongoing development activities through the potential approval of Surfaxin in 2011, including activities to advance Surfaxin LS and Aerosurf to our planned Phase 3 and Phase 2 clinical trials. In addition, our 2010 CEFF, subject to certain conditions that we must meet, may allow us to raise additional capital, although there can be no assurance that the CEFF will be available, and if the CEFF is available at any time, that we will be able to raise sufficient capital when needed. *See*, "– Liquidity and Capital Resources – Common Stock Offerings – Financings under the 2008 Shelf Registration Statement," and "– Committed Equity Financing Facilities." As of November 12, 2010, our December 2008 CEFF and the May 2008 CEFF are not available because the closing market price of our common stock ($0.21) was below the minimum price required ($0.60 and $1.15, respectively) to utilize those facilities.

Our future capital requirements depend upon many factors, including the success of our efforts to secure one or more strategic alliances or other collaboration arrangements, to support our product development activities and, if approved, commercialization plans. We continue to consider potential strategic alliances and alternatives, including additional financings and other similar opportunities. We believe that our ability to successfully enter into meaningful strategic alliances will likely improve with advances that we may make filing the Complete Response and receiving potential FDA approval for Surfaxin, and in advancing the development and regulatory pathway of our Surfaxin LS and Aerosurf programs leading to initiation of clinical trials. There can be no assurance, however, that we will be able to secure strategic partners or collaborators to support and advise our activities, that our research and development projects will be successful, that products developed will obtain necessary regulatory approval, that any approved product will be commercially viable, that any CEFF will be available for future financings, or that we will be able to obtain additional capital when needed on acceptable terms, if at all. Even if we succeed in securing strategic alliances, raising additional capital and developing and subsequently commercializing product candidates, we may never achieve sufficient sales revenue to achieve or maintain profitability.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements, in conformity with accounting principles generally accepted in the United States, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. There have been no changes to our critical accounting policies since December 31, 2009. For more information on critical accounting policies, *see* our 2009 Form 10-K. Readers are encouraged to review these disclosures in conjunction with their review of this Quarterly Report on Form 10-Q.

RESULTS OF OPERATIONS

The net loss for the three and nine months ended September 30, 2010 was $6.6 million (or $0.03 per share) and $13.4 million (or $0.08 per share), respectively. The net loss for the three and nine months ended September 30, 2009 was $8.9 million (or $0.07 per share) and $27.1 million (or $0.24 per share), respectively

Research and Development Expenses

Our research and development expenses are charged to operations as incurred and we track such costs by category rather than by project. As many of our research and development activities form a foundation for the development of our KL_4 surfactant technology platform, they benefit more than a single project. For that reason, we cannot reasonably estimate the costs or our research and development activities on a project-by-project basis. We believe that tracking our expenses by category is a more accurate method of accounting for these activities. Our research and development costs consist primarily of expenses associated with (a) manufacturing development, (b) development operations, and (c) direct pre-clinical and clinical programs.

Research and development expenses for the three and nine months ended September 30, 2010 were $4.7 million and $13.2 million, respectively. Research and development expenses for the three and nine months ended September 30, 2009 were $4.5 million and $15.2 million, respectively. These costs are charged to operations as incurred and are tracked by category, as follows:

(in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
Research and Development Expenses:	**2010**	**2009**	**2010**	**2009**
Manufacturing development	$ 2,846	$ 2,290	$ 7,492	$ 7,895
Development operations	1,178	1,263	3,778	4,720
Direct preclinical and clinical programs	703	977	1,953	2,574
Total Research & Development Expenses (1)	$ 4,727	$ 4,530	$ 13,223	$ 15,189

(1) Included in research and development expenses are charges associated with stock-based employee compensation in accordance with the provisions of Accounting Standards Codification (ASC) Topic 718. For the three and nine months ended September 30, 2010, these charges were $0.1 million and $0.4 million, respectively. For the three and nine months ended September 30, 2009, these charges were $0.1 million and $0.5 million, respectively.

Manufacturing Development

Manufacturing development includes the cost of our manufacturing operations, quality assurance and analytical chemistry capabilities to assure adequate production of clinical and potential commercial drug supply for our KL_4 surfactant products, in conformance with current good manufacturing practices (cGMP). These costs include employee expenses, facility-related costs, depreciation, costs of drug substances (including raw materials), supplies, quality control and assurance activities and analytical services, etc.

The increase of $0.6 million in manufacturing development expenses for the three months ended September 30, 2010, as compared to the same period in 2009, is primarily due to costs incurred preparing for the initiation of the manufacture of three Surfaxin LS cGMP process validation batches through a third-party contract manufacturing organization (CMO).

The decrease of $0.4 million in manufacturing development expenses for the nine months ended September 30, 2010, as compared to the same period in 2009, is primarily due to our efforts to conserve financial resources following receipt of the April 2009 Complete Response Letter and raw material purchases in the first half of 2009 offset by CMO related costs incurred in the third quarter of 2010.

Development Operations

Development operations includes: (i) medical, scientific, clinical, regulatory, data management and biostatistics activities in support of our KL_4 surfactant development programs; (ii) medical affairs activities to provide scientific and medical education support in connection with our KL_4 surfactant technology pipeline programs; (iii) design and development for the manufacture of our novel capillary aerosolization systems, including an aerosol generating device, the disposable dose delivery packets and patient interface system necessary to administer Aerosurf for our planned Phase 2 clinical trials and; (iv) pharmaceutical development activities, including development of a lyophilized formulation of our KL_4 surfactant. These costs include personnel, expert consultants, outside services to support regulatory, data management and device development activities, symposiums at key neonatal medical meetings, facilities-related costs, and other costs for the management of clinical trials.

The decrease of $0.1 million and $0.9 million in development operations expenses for the three and nine months ended September 30, 2010, as compared to the same periods in 2009, is primarily due to our efforts to conserve financial resources following receipt of the April 2009 Complete Response Letter, including, in 2009, a reduction of our workforce and a restructuring of certain functions in research and development, primarily medical affairs.

Direct Preclinical and Clinical Programs

Direct pre-clinical and clinical programs include: (i) pre-clinical activities, including toxicology studies and other pre-clinical studies to obtain data to support potential Investigational New Drug (IND) and NDA filings for our product candidates; (ii) activities associated with conducting human clinical trials, including patient enrollment costs, external site costs, clinical drug supply and related external costs such as contract research consultant fees and expenses; and (iii) activities related to addressing the items identified in the April 2009 Complete Response Letter.

Direct pre-clinical and clinical programs expenses for the three and nine months ended September 30, 2010 included: (i) costs associated with activities to address issues identified in the April 2009 Complete Response Letter, including optimization and revalidation of the BAT and studies under our comprehensive program; (ii) activities associated with the recently completed Phase 2 clinical trial evaluating the use of Surfaxin in children up to two years of age suffering with ARF; and (iii) pre-clinical and preparatory activities for our planned Phase 3 clinical program for Surfaxin LS and our Phase 2 clinical program for Aerosurf.

The decrease of $0.3 million in direct preclinical and clinical program expenses for the three months ended September 30, 2010, as compared to the same period in 2009, is primarily due to the completion of the Phase 2 clinical trial for ARF during the first half of 2010. The decrease of $0.6 million in direct preclinical and clinical program expenses for the nine months ended September 30, 2010, as compared to the same period in 2009, is primarily due to completion of the Phase 2 clinical trial for ARF during the first half of 2010 offset by increased costs associated with activities related to addressing the items identified in the April 2009 Complete Response Letter.

In an effort to conserve our financial resources, we plan to continue limiting investments in clinical programs until we have secured appropriate strategic alliances and necessary capital. We also plan to meet with U.S. and European regulatory authorities to discuss the requirements for our regulatory packages, including potential trial design requirements, to prepare for our planned clinical trials.

Research and Development Projects

A substantial portion of our cumulative losses to date, including approximately $71.8 million in the three-year period ending December 31, 2009, relate to investments in our research and development activities. Due to the significant risks and uncertainties inherent in the clinical development and regulatory approval processes, the nature, timing and costs of the efforts necessary to complete individual projects in development are not reasonably estimable. With every phase of a development project, there are significant unknowns that may significantly impact cost projections and timelines. As a result of the number and nature of these factors, many of which are outside our control, the success, timing of completion and ultimate cost, of development of any of our product candidates is highly uncertain and cannot be estimated with any degree of certainty.

Certain of the risks and uncertainties affecting our ability to estimate projections and timelines are discussed in our 2009 Form 10-K at "Item 1– Business – Government Regulation;" and in "Item 1A – Risk Factors – The regulatory approval process for our products is expensive and time-consuming and the outcome is uncertain. We may not obtain required regulatory approvals for the commercialization of our products;" "– Our research and development activities involve significant risks and uncertainties that are inherent in the clinical development and regulatory approval processes;" "– Our ongoing clinical trials may be delayed, or fail, which will harm our business," "– The manufacture of our drug products is a highly exacting and complex process, and if we, our contract manufacturers or any of our materials suppliers encounter problems manufacturing our products or the drug substances used to make our products, this could potentially cause us to delay development or clinical programs or, following approval, product launch, or cause us to experience shortages of products inventories;" as well as elsewhere in our 2009 Form 10-K.

Our lead development projects are initially focused on the management of RDS in premature infants and include Surfaxin, Surfaxin LS and Aerosurf. We believe that these neonatal programs have the potential to greatly improve the management of RDS and expand the current RDS market worldwide. All of these potential products are either in regulatory review or clinical or pre-clinical development and none are available for commercial sale. While we anticipate that we will be in a position to file a complete response with the FDA with respect to Surfaxin for the prevention of RDS in premature infants in the first quarter 2011, which could lead to potential approval of Surfaxin in 2011, there can be no assurance that we will be successful in securing such approval or that, if approved, we will be successful in commercializing Surfaxin and realizing a profit in the foreseeable future. We are preparing for clinical programs for Surfaxin LS and Aerosurf; however, our ability to move forward will depend upon the success of our efforts to secure appropriate strategic alliances and capital to fund these activities. Accordingly, we are unable to project when we might implement these programs, the pace of such implementation or the overall anticipated expense that we might incur.

The status of our lead projects and our other pipeline candidates, including the potential timing and milestones for each, is discussed in our 2009 Form 10-K at "Item 1– Business – Surfactant Replacement Therapy for Respiratory Medicine." See also, "Item 1 – Business – Business Strategy," and "Item 1A – Risk Factors – We may not successfully develop and market our products, and even if we do, we may not become profitable," "– We will require significant additional capital to continue our planned research and development activities and continue to operate as a going concern. Moreover, such additional financing could result in equity dilution" *See also*, "Business and KL_4 Pipeline Programs Update," in this MD&A, above.

In addition to our lead products, we plan over time to develop our KL_4 surfactant technology into a broad product pipeline that potentially will address a variety of debilitating respiratory conditions in patient populations ranging from premature infants to adults. After we have completed Phase 2 proof-of-concept studies for each potential indication, if successful, we plan to assess the potential markets for these products and determine whether to seek strategic alliances or collaboration arrangements, or utilize other financial alternatives to fund their further development. At the present time, however, we continue to conserve our resources, predominantly by curtailing and pacing investments in these pipeline programs. *See*, "Item 1 – Business – Business Operations," and " – Surfactant Replacement Therapy For Respiratory Medicine" in our 2009 Form 10-K, and "Business and KL_4 Pipeline Programs Update," in this MD&A, above.

Our ability to generate sufficient capital to support our product development activities and, if approved, commercialization plans, depends upon many factors, including the success of our efforts to secure one or more strategic alliances or other collaboration arrangements. We believe that our ability to successfully enter into meaningful strategic alliances will likely improve with any advances that we may make in finalizing our development efforts and filing the Complete Response for Surfaxin, and in our Surfaxin LS and Aerosurf programs leading to initiation of clinical trials. There can be no assurance, however, that we will be able to secure strategic partners or collaborators to support and provide expert advice to guide our activities, that our research and development projects will be successful, or that we will be able to obtain additional capital to support our activities when needed on acceptable terms, if at all.

Ultimately, if we do not successfully develop and gain marketing approval for our drug product candidates, in the United States or elsewhere, we will not be able to commercialize, or generate any revenues from the sale of, our products and the value of our company and our financial condition and results of operations will be substantially harmed.

General and Administrative Expenses

General and administrative expenses consist primarily of the costs of executive management, business and commercial development, finance and accounting, intellectual property and legal, human resources, information technology, facility and other administrative costs.

General and administrative expenses for the three months ended September 30, 2010 and 2009 were $1.5 million and $2.4 million, respectively. Included in general and administrative expenses were charges associated with stock-based compensation of $0.2 million and $0.1 million, respectively. In addition, general and administrative expenses for the three months ended September 30, 2009 include a one-time charge of $0.7 million associated with certain contractual cash severance obligations to our former President and Chief Executive officer. Excluding the one-time charge related to our severance obligation and charges associated with stock-based compensation, general and administrative expenses decreased $0.3 million for the three months ended September 30, 2010 as compared to the same period in 2009.

General and administrative expenses for the nine months ended September 30, 2010 and 2009 were $6.3 million and $8.1 million, respectively. Included in general and administrative expenses were charges associated with stock-based compensation of $0.7 million and $1.5 million, respectively. Additionally, general and administrative expenses for the nine months ended September 30, 2010 and 2009 include one-time charges of $1.0 million and $0.7 million, respectively, associated with certain contractual cash severance obligations to our former President and Chief Executive officer. Excluding the one-time charge related to our severance obligation and charges associated with stock-based compensation, general and administrative expenses decreased $1.3 million for the nine months ended September 30, 2010 as compared to the same period in 2009. The decrease was primarily due to investments in pre-launch commercial capabilities in the first half of 2009 in anticipation of the potential approval and commercial launch of Surfaxin as well as cost containment measures and workforce reduction following receipt of the April 2009 Complete Response Letter for Surfaxin.

Change in Fair Value of Common Stock Warrant Liability

We account for common stock warrants in accordance with applicable accounting guidance provided in ASC 815 - “Derivatives and Hedging — Contracts in Entity’s Own Equity”, as either derivative liabilities or as equity instruments depending on the specific terms of the warrant agreement. Derivative warrant liabilities are valued using the Black-Scholes pricing model at the date of initial issuance and each subsequent balance sheet date. Changes in the fair value of the warrants are reflected in the consolidated statement of operations as “Change in the fair value of common stock warrant liability.”

The change in the fair value of common stock warrant liability for the three and nine months ended September 30, 2010 resulted in expense of $0.4 million and income of $6.4 million, respectively, due primarily to changes in our common stock share price during the periods.

The change in the fair value of common stock warrant liability, for the warrants issued in May 2009, for the three and nine months ended September 30, 2009 resulted in expense of $1.7 million and $3.0 million, respectively, due primarily to an increase in our common stock share price during the periods.

Other Income and (Expense)

Other income and (expense) for the three and nine months ended September 30, 2010 were $(16,000) and $(0.3) million, respectively. Other income and (expense) for the three and nine months ended September 30, 2009 were $(0.2) million and $(0.8) million, respectively.

(Dollars in thousands)	Three months ended September 30,		Nine months ended September 30,	
	2010	2009	2010	2009
Interest income	$ 3	$ 8	$ 9	$ 29
Interest expense	(19)	(252)	(350)	(834)
Other income / (expense)	–	–	18	–
Other income / (expense), net	$ (16)	$ (244)	$ (323)	$ (805)

Interest income consists of interest earned on our cash and marketable securities. To ensure preservation of capital, we invest most of our cash and marketable securities in a treasury-based money market fund.

Interest expense consists of interest accrued on the outstanding balance of our loan with PharmaBio and under our equipment financing facilities. In addition, interest expense includes expenses associated with the amortization of deferred financing costs for the warrant that we issued to PharmaBio in October 2006 as consideration for a restructuring of our loan in 2006. These costs were fully amortized as of April 2010.

The decrease in interest expense for the three and nine months ended September 30, 2010 as compared to the same periods for 2009 is due to the full amortization of deferred financing costs associated with the warrant that we issued to PharmaBio in October 2006 and a reduction in the outstanding principal balances on our equipment loans.

LIQUIDITY AND CAPITAL RESOURCES

Overview

We have incurred substantial losses since inception due to investments in research and development, manufacturing and potential commercialization activities and we expect to continue to incur substantial losses over the next several years. Historically, we have funded our business operations through various sources, including public and private securities offerings, draw downs under our CEFFs, capital equipment and debt facilities, and strategic alliances. We expect to continue to fund our business operations through a combination of these sources, and, upon regulatory approval, also through sales revenue from our product candidates, beginning with Surfaxin for the prevention of RDS, if approved.

Following receipt from the FDA of a Complete Response Letter for Surfaxin in April 2009, we made fundamental changes in our business strategy. We now believe that it is in our best interest financially to seek to develop and commercialize our KL_4 surfactant technology through strategic alliances or other collaboration arrangements, including in the United States. However, there can be no assurance that any strategic alliance or other arrangement will be successfully concluded.

The accompanying interim unaudited consolidated financial statements have been prepared assuming that we will continue as a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. As a result of our cash position as of December 31, 2009, the audit opinion we received from our independent auditors for the year ended December 31, 2009 contains a notation related to our ability to continue as a going concern. Our ability to continue as a going concern is dependent on our ability to raise additional capital, to fund our research and development and commercial programs and meet our obligations on a timely basis. If we are unable to successfully raise sufficient additional capital, through strategic and collaborative arrangements with potential partners and/or future debt and equity financings, we will likely not have sufficient cash flows and liquidity to fund our business operations, which could significantly limit our ability to continue as a going concern.

In addition, as of October 29, 2010, we have authorized capital available for issuance (and not otherwise reserved) of approximately 48.5 million shares of common stock. We have presented to our stockholders, for approval at our 2010 Annual Meeting of Stockholders on December 21, 2010, a proposal to authorize our Board, in its sole discretion, to effect a share consolidation, or reverse stock split (reverse split) of our common stock, at a ratio of 1-for-15, on the terms described in the Proxy Statement. If implemented, a reverse split would result in a share consolidation of all outstanding shares of our common stock, but would not affect the number of authorized shares of capital stock provided in our Certificate of Incorporation. We, therefore, also submitted to our stockholders a proposal that, if and only if the reverse split is approved, would reduce the total number of authorized shares of common stock from 380 million to 50 million. If approved, these proposals will result in an increase in the number of shares of common stock available for issuance (and not otherwise reserved) and will allow us to potentially raise additional capital, through strategic and collaborative arrangements with potential partners and/or future debt and equity financings.

If for any reason, these proposals are not approved, we may be unable to undertake additional financings without first seeking stockholder approval, a process that would require a special meeting of stockholders, a time-consuming and expensive process that could impair our ability to efficiently raise capital when needed, if at all. In that case, we may be forced to further limit development of many, if not all, of our programs. If we are unable to raise the necessary capital, we may be forced to curtail all of our activities and, ultimately, potentially cease operations. Even if we are able to raise additional capital, such financings may only be available on unattractive terms, or could result in significant dilution of stockholders' interests and, in such event, the market price of our common stock may decline. Our financial statements do not include any adjustments relating to recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should we be unable to continue in existence.

Our future capital requirements depend upon many factors, including the success of our efforts to secure one or more strategic alliances or other collaboration arrangements, to support our product development activities and, if approved, commercialization plans. We are also considering other alternatives, including additional financings and other similar opportunities. There can be no assurance, however, that we will be able to secure strategic partners or collaborators to support and advise our activities, that our research and development projects will be successful, that products developed will obtain necessary regulatory approval, that any approved product will be commercially viable, that any CEFF will be available for future financings, or that we will be able to obtain additional capital when needed on acceptable terms, if at all. Even if we succeed in securing strategic alliances, raising additional capital and developing and subsequently commercializing product candidates, we may never achieve sufficient sales revenue to achieve or maintain profitability.

On April 28, 2010, we restructured our $10.6 million loan with PharmaBio and paid in cash principal and interest totaling $6.6 million, and extended payment of the remaining $4 million principal amount under the loan, $2 million became due and was paid on each of July 30, 2010 and September 30, 2010. *See*, "– Debt – Loan with PharmaBio Development Inc." Also under the PharmaBio Agreement, PharmaBio surrendered to us for cancellation warrants to purchase an aggregate of 2,393,612 shares of our common stock that we had issued previously to PharmaBio in connection with the PharmaBio loan and a previous offering of securities. As of September 30, 2010, all of our obligations related to the loan with PharmaBio were paid in full. See, " – Debt – Loan with PharmaBio Development Inc."

Also, on April 27, 2010, PharmaBio agreed to purchase 4,052,312 shares of our common stock and warrants to purchase an aggregate of 2,026,156 shares of common stock, priced as units consisting of one share and one-half of a warrant to purchase one share, at an offering price of $0.5429 per unit, resulting in gross proceeds to us, on April 29, 2010, of $2.2 million ($2.1 million net). The warrants generally will expire in April 2015 and generally will be exercisable beginning on October 28, 2010 at an exercise price per share of $0.7058 per share and, if exercised in full, would result in additional proceeds to us of approximately $1.4 million. *See*, "– Common Stock Offerings – Financings under the 2008 Shelf Registration Statement."

The April 2010 PharmaBio Agreement also provides that we and PharmaBio will negotiate in good faith to potentially enter into a strategic arrangement under which PharmaBio would provide funding for a research collaboration between Quintiles and us relating to the possible research and development, and commercialization of two of our drug product candidates, Surfaxin LS and Aerosurf, for the prevention and treatment of RDS in premature infants. However, neither party is obligated to enter into any such arrangement except to the extent that the parties, in their individual and sole discretion, enter into definitive documents with respect thereto. Accordingly, there can be no assurances that any such arrangement will be completed.

On June 11, 2010, we entered into a Committed Equity Financing Facility (2010 CEFF) with Kingsbridge Capital Limited (Kingsbridge) under which we generally are entitled to sell, and Kingsbridge is obligated to purchase, from time to time over a period of three years, subject to certain conditions and restrictions, shares of our common stock for cash consideration of up to an aggregate of the lesser of $35 million or 31,597,149 shares. Kingsbridge's obligation to purchase shares of our common stock is subject to satisfaction of certain conditions at the time of each draw down, as specified in the Purchase Agreement. In connection with the 2010 CEFF, we issued a warrant to Kingsbridge to purchase up to 1,250,000 shares of our common stock at a price of $0.4459 per share, which is fully exercisable (in whole or in part) beginning December 11, 2010 and for a period of five years thereafter. If exercised in full, the warrant potentially could result in additional proceeds to us of approximately $560,000. *See*, " –Committed Equity Financing Facilities (CEFFs)."

On June 22, 2010, we completed a public offering of 35.7 million shares of our common stock, five-year warrants to purchase 17.9 million shares of our common stock, and short-term (nine month) warrants to purchase 17.9 million shares of our common stock. The securities were sold as units, with each unit consisting of one share of common stock, a five-year warrant to purchase one half share of common stock, and a short-term warrant to purchase one half share of common stock, at a public offering price of $0.28 per unit, resulting in gross proceeds to us of $10 million ($9.1 million net). If exercised in full, the short-term warrants would result in additional proceeds to us of approximately $5 million, and the long-term warrants, $7.1 million. This offering was made pursuant to our existing shelf registration statement on Form S-3 (File No. 333-151654), which was filed with the SEC on June 13, 2008 and declared effective by the SEC on June 18, 2008 (2008 Shelf Registration Statement).

On October 12, 2010, PharmaBio agreed to purchase 2,380,952 shares of our common stock and warrants to purchase an aggregate of 1,190,476 shares of common stock, sold as units consisting of one share of common stock and one warrant to purchase one-half of a share of common stock, at an offering price of $0.21 per unit, resulting in gross proceeds to us of $500,000. The warrants generally will expire in October 2015 and are immediately exercisable for cash (except in certain limited circumstances), subject to an aggregate beneficial ownership limitation of 9.99%, at an exercise price per share of $0.273 per share and, if exercised in full, would result in additional proceeds to us of approximately $0.325 million. *See*, "– Common Stock Offerings – Financings under the 2008 Shelf Registration Statement."

As of September 30, 2010, we had cash and cash equivalents of $14.7 million, which includes net proceeds of $0.6 million in September 2010 from the first of two settlements from a September 2010 draw down on our 2010 CEFF. We will require additional capital to support our ongoing development activities through the potential approval of Surfaxin in 2011, including activities to advance Surfaxin LS and Aerosurf to our planned Phase 3 and Phase 2 clinical trials. We recently received payment of a non-dilutive grant under the Patient Protection and Affordable Care Act of 2010 in the amount of approximately $0.25 million to support our activities related to Aerosurf. In addition, our 2010 CEFF, subject to certain conditions that we must meet, may allow us to raise additional capital, although there can be no assurance that the CEFF will be available, and if the CEFF is available at any time, that we will be able to raise sufficient capital when needed. As of November 12, 2010, our December 2008 CEFF and the May 2008 CEFF were not available because the closing market price of our common stock on that date ($0.21) was below the minimum price required ($0.60 and $1.15, respectively) to utilize those facilities. *See*, "– Committed Equity Financing Facilities (CEFFs)," below.

To meet our capital requirements, we continue to consider multiple strategic alternatives, including, but not limited to potential business alliances, commercial and development partnerships, additional financings and other similar opportunities, although there can be no assurance that we will take any further specific actions or enter into any transactions. Until such time as we secure the necessary capital, we plan to continue conserving our financial resources, predominantly by limiting investments in our pipeline programs.

Cash Flows

As of September 30, 2010, we had cash and cash equivalents of $14.7 million compared to $15.7 million as of December 31, 2009. Cash outflows before financings for the nine months ended September 30, 2010 consisted of $15.5 million used for ongoing operating activities, a one-time payment of $1.1 million to satisfy our severance obligations to our former President and Chief Executive Officer, and $11.2 million used for debt service (primarily payments of $10.6 million of principal and accrued interest to PharmaBio).

Cash Flows Used in Operating Activities

Cash flows used in operating activities were $18.7 million and $21.4 million for the nine months ended September 30, 2010 and 2009, respectively.

Our cash flows used in operating activities are a result of our net operating losses adjusted for non-cash items associated with stock-based compensation, fair value adjustment of common stock warrant, depreciation and changes in our accounts payable, accrued liabilities and receivables. Cash flows used in operating activities for the nine months ended September 30, 2010 and 2009 included one-time payments of $1.1 million and $0.3 million, respectively, to satisfy our severance obligations to our former President and Chief Executive Officer. Additionally, for the nine months ended September 30, 2010, cash flows from operating activities included a $2.1 million interest payment in connection with satisfying our PharmaBio loan.

Cash Flows Used in Investing Activities

Cash flows used in investing activities included purchases of equipment of $0.1 million and $0.1 million for the nine months ended September 30, 2010 and 2009, respectively.

Cash Flows from/(used in) Financing Activities

Cash flows from financing activities were $17.7 million and $14.2 million for the nine months ended September 30, 2010 and 2009, respectively.

Cash flows from financing activities for the nine months ended September 30, 2010 primarily included net proceeds of $15.1 million from the February 2010 public offering, $2.1 million from the April 2010 offering to PharmaBio, $9.1 million from the June 2010 public offering, and $0.6 million from the first of two settlements from a September draw down on our June 2010 CEFF. Cash flows used in financing activities reflect principal payments on our equipment loan and capital lease obligations of $0.6 million and principal payments on our PharmaBio loan of $8.5 million. *See*, "– Debt – Loan with PharmaBio Development Inc," and "– Common Stock Offerings – Financings under the 2008 Shelf Registration Statement."

Cash flows from financing activities for the nine months ended September 30, 2009 included net proceeds of $10.5 from our May 2009 Registered Direct Offering and $6.0 million from financings pursuant to our CEFFs, partially offset by $2.3 million of principal payments on our equipment loans.

Committed Equity Financing Facilities (CEFFs)

On June 11, 2010, we entered into the 2010 CEFF with Kingsbridge. The 2010 CEFF is our fifth CEFF with Kingsbridge since 2004. As of September 30, 2010, we had three effective CEFFs, as follows: (i) the 2010 CEFF; (ii) the CEFF dated December 12, 2008 (December 2008 CEFF), and (iii) the CEFF dated May 22, 2008 (May 2008 CEFF), which allow us to raise capital for a period of three years ending June 11, 2013, June 18, 2011 and February 6, 2011, respectively, at the time and in amounts deemed suitable to us to support our business plans. We are not obligated to utilize any of the funds available under the CEFFs. Our ability to access funds under the CEFFs is subject to minimum price requirements, volume limitations and other conditions.

As of September 30, 2010, under the 2010 CEFF, we had approximately 28.5 million shares potentially available for issuance (up to a maximum of $34.4 million), provided that the volume-weighted average price (VWAP) on each trading day must be at least equal to the greater of $0.20 or 90% of the closing market price on the day preceding the first day of draw down (Minimum VWAP). Under the December 2008 CEFF, we had 7.1 million shares potentially available for issuance (up to a maximum of $17.7 million), provided that the VWAP on each trading day during the draw-down period must be at least equal to the greater of $.60 or the Minimum VWAP Under the May 2008 CEFF, we had approximately 12.8 million shares potentially available for issuance (up to a maximum of $51.7 million), provided that the VWAP on each trading day must be at least equal to the greater of $1.15 or the Minimum VWAP. Use of each CEFF is subject to certain other covenants and conditions, including aggregate share and dollar limitations for each draw down. *See*, our 2009 Form 10-K – "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Committed Equity Financing Facilities (CEFFs)" and, for a detailed description of our 2010 CEFF, our Quarterly Report on Form 10-Q, for the period ending June 30, 2010 – Note 5 – Committed Equity Financing Facilities (CEFFs) – 2010 CEFF.

On October 4, 2010, we completed a financing under our 2010 CEFF resulting in gross proceeds of approximately $1.0 million from the issuance of 5,272,361 shares of our common stock at an average price per share, after applicable fees and discounts, of $0.18. The settlement dates for this draw down were September 28, 2010 and October 4, 2010, respectively.

On November 9, 2010, we completed a financing under our 2010 CEFF resulting in gross proceeds of approximately $.36 million from the issuance of 2,488,218 shares of our common stock at an average price per share, after applicable fees and discounts, of $0.17. The settlement dates for this draw down were November 4, 2010 and November 9, 2010.

As of November 12, 2010, the 2010 CEFF was available, subject to certain conditions that we must meet, but the December 2008 CEFF and the May 2008 CEFF were not available because the closing market price of our common stock on that date ($0.21) was below the minimum price required ($0.60 and $1.15, respectively) to utilize those facilities. *See*, "– Common Stock Offerings – Financings under the 2008 Shelf Registration Statement."

During 2009, we raised an aggregate of $10.7 million from 10 draw-downs under our CEFFs. We anticipate using our CEFFs (at such times as our stock price is at least equal to the minimum price requirement) to support our working capital needs and maintain cash availability in 2010.

Common Stock Offerings

Historically, we have funded, and expect that we may continue to fund, our business operations through various sources, including financings in the form of common stock offerings. On June 13, 2008, we filed our 2008 Shelf Registration Statement (on Form S-3 (No. 333-151654), and declared effective on June 18, 2008) for the proposed offering from time to time of up to $150 million of our securities, including common stock, preferred stock, varying forms of debt and warrant securities, or any combination of the foregoing, on terms and conditions that will be determined at that time.

Financings under the 2008 Shelf Registration Statement

On October 12, 2010, we entered into a Securities Purchase Agreement with PharmaBio, as the sole purchaser, pursuant to which PharmaBio agreed to purchase 2,380,952 shares of our common stock and warrants to purchase an aggregate of 1,190,476 shares of common stock, sold as units consisting of one share of common stock and one warrant to purchase one-half of a share of common stock, at an offering price of $0.21 per unit, representing, the greater of (a) the VWAP on the Nasdaq Capital Market for 10 consecutive trading days ending on October 11, 2010 and (b) the VWAP on October 11, 2010. This offering resulted in gross proceeds to us of $0.5 million. The warrants generally will expire in October 2015 and are immediately exercisable, subject to an aggregate beneficial ownership limitation of 9.99%, at an exercise price per share of $0.273 per share and, if exercised in full, would result in additional proceeds to us of approximately $0.325 million. The warrants are exercisable for cash only, except that if the related registration statement or an exemption from registration is not otherwise available for the sale of the warrant shares, the holder may exercise on a cashless basis. In addition, upon 20 days' written notice to the holder of the warrant, we may redeem any or all of the warrants at any time within 20 days following the occurrence of a "trading threshold" (as defined below) at a per-warrant redemption price of $0.001. A "trading threshold" will be deemed to have occurred on any date that the reported VWAP for five of the immediately preceding seven consecutive trading days exceeds $0.45, provided that the minimum average daily trading volume of our common stock during the seven-day period is at least 500,000 shares (the price and volume criteria being adjusted to take into account any share dividend, share split or other similar transaction that may occur on or after the issuance).

On June 22, 2010, we completed a public offering of 35.7 million shares of our common stock, five-year warrants to purchase 17.9 million shares of our common stock (Five-Year Warrants), and short-term (nine month) warrants to purchase 17.9 million shares of our common stock (Short-Term Warrants). The securities were sold as units, with each unit consisting of one share of common stock, a Five-Year Warrant to purchase one half share of common stock, and a Short-Term Warrant to purchase one half share of common stock, at a public offering price of $0.28 per unit, resulting in gross proceeds to us of $10 million ($9.1 million net). The Five-Year Warrants expire on June 22, 2015 and are exercisable, subject to an aggregate beneficial ownership limitation, at a price per share of $0.40. The Short-Term Warrants expire on March 22, 2011 and are exercisable, subject to an aggregate beneficial ownership limitation, at a price per share of $0.28. The exercise price and number of shares of common stock issuable on exercise of the warrants are subject to adjustment in the event of any stock split, reverse stock split, stock dividend, recapitalization, reorganization or similar transaction, among other events as described in the warrants. The exercise price and the amount and/or type of property to be issued upon exercise of the warrants are also subject to adjustment if we engage in a "Fundamental Transaction" (as defined in the form of warrant). The warrants are exercisable for cash only, except that if the related registration statement or an exemption from registration is not otherwise available for the resale of the warrant shares, the holder may exercise on a cashless basis.

On April 27, 2010, we entered into a Securities Purchase Agreement with PharmaBio, as the sole purchaser, related to an offering of 4,052,312 shares of common stock and warrants to purchase an aggregate of 2,026,156 shares of common stock, sold as units with each unit consisting of one share of common stock and a warrant to purchase one half share of common stock, at an offering price of $0.5429 per unit, representing the greater of (a) the VWAP of our common stock on The Nasdaq Global Market for the 20 trading days ending on April 27, 2010 and (b) the last reported closing price of $0.5205 per share of the common stock on The Nasdaq Global Market on that date. The offering resulted in gross proceeds to us of $2.2 million ($2.1 million net). The warrants expire in April 2015 and generally will be exercisable beginning on October 28, 2010, subject to an aggregate beneficial ownership limitation of 9.9%, at a price per share of $0.7058, which represents a 30% premium to the VWAP for the 20 trading days ending on April 27, 2010. The exercise price and number of shares of common stock issuable on exercise of the warrants will be subject to adjustment in the event of any stock split, reverse stock split, stock dividend, recapitalization, reorganization or similar transaction. The exercise price and the amount and/or type of property to be issued upon exercise of the warrants will also be subject to adjustment if we engage in a "Fundamental Transaction" (as defined in the form of warrant). The warrants are exercisable for cash only, except that if the related registration statement or an exemption from registration is not otherwise available for the resale of the warrant shares, the holder may exercise on a cashless basis.

In February 2010, we completed a public offering of 27.5 million shares of our common stock and warrants to purchase 13.8 million shares of our common stock, sold as units, with each unit consisting of one share of common stock and a warrant to purchase one half share of common stock, at a public offering price of $0.60 per unit, resulting in gross proceeds to us of $16.5 million ($15.1 million net). The warrants expire in February 2015 and are exercisable, subject to an aggregate share ownership limitation, at a price per share of $0.85. The exercise price and number of shares of common stock issuable on exercise of the warrants will be subject to adjustment in the event of any stock split, reverse stock split, stock dividend, recapitalization, reorganization or similar transaction. The exercise price and the amount and/or type of property to be issued upon exercise of the warrants will also be subject to adjustment if we engage in a "Fundamental Transaction" (as defined in the warrant agreement). The warrants are exercisable for cash only, except that if the related registration statement or an exemption from registration is not otherwise available for the resale of the warrant shares, the holder may exercise on a cashless basis.

As of September 30, 2010, $75.0 million remained available under the 2008 Shelf Registration Statement for potential future offerings. If the aggregate market value of our common stock remains below $75.0 million, the number of shares that we may offer and sell pursuant to this shelf registration statement within any 12 calendar month period may be limited to one third of the aggregate market value of our common stock held by held by non-affiliates (known as "public float").

Debt

Historically, we have, and expect to continue to, fund our business operations through various sources, including debt arrangements such as credit facilities and equipment financing facilities.

Loan with PharmaBio Development Inc.

On April 28, 2010, we restructured our $10.6 million loan with PharmaBio. The related Payment Agreement and Loan Amendment dated April 27, 2010 (PharmaBio Agreement) provided for (a) payment in cash of an aggregate of $6.6 million, representing $4.5 million in outstanding principal and $2.1 million in accrued interest, and (b) of the remaining $4 million principal amount under the loan, $2 million became due and was paid on each of July 30, 2010 and September 30, 2010. Also under the PharmaBio Agreement, PharmaBio surrendered to us for cancellation warrants to purchase an aggregate of 2,393,612 shares of our common stock that we had issued previously to PharmaBio in connection with the PharmaBio loan and a previous offering of securities, as follows: a warrant to purchase 850,000 shares of common stock, at $7.19 per share expiring on November 3, 2014, a warrant to purchase 1,500,000 shares of common stock at $3.58 per share expiring on October 26, 2013 and a warrant to purchase 43,612 shares of our common stock at $6.875 per share expiring on September 19, 2010. As of September 30, 2010, all of our obligations related to the loan with PharmaBio were paid in full.

Equipment Financing Facilities

As of September 30, 2010, approximately $0.1 million ($0.1 million classified as current liabilities and $5,000 as long-term liabilities) was outstanding under a May 2007 Credit and Security Agreement with GE Business Financial Services Inc. (GE, formerly Merrill Lynch Business Financial Services Inc). The right to draw under this facility expired in 2008.

In September 2008, we entered into a Loan Agreement and Security Agreement with the Commonwealth of Pennsylvania, Department of Community and Economic Development (Department), pursuant to which the Department made a loan to us from the Machinery and Equipment Loan Fund in the amount of $500,000 (MELF Loan). As of September 30, 2010, approximately $0.4 million was outstanding under the facility ($0.1 million classified as current liabilities and $0.3 million as long-term liabilities).

See, our 2009 Form 10-K – "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Debt – Equipment Financing Facilities."

Contractual Obligations and Commitments

During the nine-month period ended September 30, 2010, there were no material changes to our contractual obligations and commitments disclosures as set forth in our 2009 Form 10-K, "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Contractual Obligations," except as noted below.

In connection with the resignation in August 2009 of Robert J. Capetola, Ph.D., our former President, Chief Executive Officer and member of our Board, we entered into a separation agreement and general release (Separation Agreement) dated August 13, 2009, that provided, among other things, for periodic severance payments through the earlier of (i) May 3, 2010 (Severance Period) or (ii) the date, if ever, of a Corporate Transaction (defined below). Under the Separation Agreement, if a "Corporate Transaction" not involving a change of control were to occur during the Severance Period, Dr. Capetola would become entitled to receive an additional severance payment of up to $1,580,000, reduced by the sum of the aggregate cash severance amounts already paid under the Separation Agreement. A "Corporate Transaction" was defined to include one or more public or private financings completed during the Severance Period and resulting in cash proceeds (net of transaction costs) to us of at least $20 million. From August 13, 2009 through February 23, 2010, we raised approximately $21.0 million of aggregate net proceeds, including approximately $5.9 million from financings under our CEFFs and $15.1 million from a public offering that was completed on February 23, 2010. Accordingly, on March 3, 2010, we paid to Dr. Capetola an additional $1.06 million (less withholding), representing $1.58 million reduced by the sum of the cash severance amounts previously paid under the Separation Agreement, which totaled approximately $0.52 million. At this time, our obligation to make periodic payments under the Separation Agreement has been satisfied and no further payments are due to Dr. Capetola. *See*, "Item 11– Executive Compensation –Resignation of our President and Chief Executive Officer," in our Amendment No. 1 to our 2009 Form 10-K that we filed with the SEC on April 30, 2010 (2009 Form 10-K/A-1).

In February 2010, we provided notice of non-renewal with respect to all of our executive employment agreements other than the agreements that we maintain with the following five officers: President and Chief Financial Officer (formerly Executive Vice President and CFO); Executive Vice President, General Counsel and Secretary; Chief Operating Officer (formerly Senior Vice President, Commercialization and Corporate Development), Chief Technology Officer (formerly Senior Vice President, Manufacturing Operations, who resigned his position in September 2010), and Senior Vice President, Human Resources. In May 2010, we entered into retention agreements with those officers whose employment agreements were not renewed that generally provide severance benefits equal to (i) six or 12 months, depending upon title, of the executive's base salary then in effect, plus a prorated bonus amount based on the executive's target bonus. In addition, the retention letter provides for six or 12 months, depending upon title, of benefits continuation. The severance benefits are conditioned upon the execution of general release of claims. These agreements expire on December 31, 2011.

On October 15, 2010, our Board appointed W. Thomas Amick, Chairman of our Board, as our full-time Chief Executive Officer effective October 18, 2010. As of October 18, 2010, we entered into an employment agreement with Mr. Amick, under which he will receive: a base salary of at least $400,000 per year and a discretionary annual bonus opportunity in the form of either cash or equity, or both, subject to the discretion of the Compensation Committee of the Board. In addition, on October 18, 2010, Mr. Amick was granted 400,000 restricted shares of our common stock (the "RSAs"). The RSAs will vest on the earliest to occur of the following: (i) the second anniversary of the date of grant; (ii) the date of issuance by FDA of marketing approval for Surfaxin® for the prevention of respiratory distress syndrome (RDS) in premature infants; and (iii) the effective date of a strategic alliance, collaboration agreement or other similar arrangement between us and one or more third parties providing for the support for the development and/or commercialization of one or more of our lead research and development programs – Surfaxin, Surfaxin LS™ or Aerosurf® (whether a transaction meets this requirement shall be determined by the Board in its sole discretion). The RSAs will vest only if Mr. Amick is actively providing services to the Company on the day of vesting.

Under Mr. Amick's employment agreement, if Mr. Amick's employment is terminated by us without "cause" or by Mr. Amick for "good reason" (both as defined in the employment agreement), he will be entitled to (a) acceleration and vesting of all stock and options then held by him, (b) a lump-sum payment equal to the product of 1.5 and the sum of (x) his then-current base salary and (y) the largest annual cash bonus paid to Mr. Amick in the three fiscal years immediately preceding the date of termination (the "Highest Annual Bonus"), (c) a pro-rata bonus payable in a lump sum equal to the Highest Annual Bonus multiplied by a fraction the numerator of which is the number of days the executive was employed in the current fiscal year and the denominator of which is 365, (d) continuation of health benefits (or their equivalent) for Mr. Amick and the members of his family who were participating in our health and welfare plans at the time of termination for 18 months after the date of termination, reduced to the extent that a subsequent employer provides the executive with substantially similar coverage (on a benefit-by-benefit basis), and (e) outplacement counseling assistance in the form of reimbursement for reasonable expenses incurred by the executive within 12 months following the date of termination, up to a maximum amount of $40,000.

In addition, following a change in control of the Company, if his employment is terminated by the Company without "cause" or by Mr. Amick for "good reason" (both as defined in the employment agreement), in lieu of the benefits described above, he will be entitled to (a) the acceleration and vesting of all stock and options then held by him, (b) a lump sum payment equal to the product of 2.5 and the sum of (x) his then current base salary and (y) the Highest Annual Bonus, (c) a pro-rata bonus payable in a lump sum equal to the Highest Annual Bonus multiplied by a fraction the numerator of which is the number of days the executive was employed with the Company in the current fiscal year and the denominator of which is 365, (d) continuation of health benefits (or their equivalent) for Mr. Amick and the members of his family who were participating in our health and welfare plans at the time of termination for 18 months after the date of termination, reduced to the extent that a subsequent employer provides the executive with substantially similar coverage (on a benefit-by-benefit basis), and (e) outplacement counseling assistance in the form of reimbursement for reasonable expenses incurred by the executive within 12 months following the date of termination, up to a maximum amount of $40,000.

The agreement also includes a 12-month post-employment noncompetition agreement, confidentiality and assignment of intellectual property provisions and an excise tax gross-up feature.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. In designing and evaluating the disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

In connection with the preparation of this Quarterly Report on Form 10-Q, our Interim Chief Executive Officer and our Chief Financial Officer evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2010. In making this evaluation, they considered that, as a result of restatements of our 2009 financial statements and our quarterly reports for the periods ended March 31, 2010 and June 30, 2010, which we filed with the SEC on November 15, 2010, a material weakness was identified in our internal control regarding our process and procedures related to the initial classification and subsequent accounting of registered warrants as liabilities or equity instruments. Solely as a result of the previously identified material weakness, our Interim Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of September 30, 2010.

Changes in internal controls

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) under the Exchange Act that occurred during the quarter ended September 30, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

To respond to the material weakness that we recently identified, we plan to devote internal resources to improving our internal control over financial reporting. While we have processes to identify and intelligently apply developments in accounting, we plan to enhance these processes to better evaluate our research and understanding of the nuances of increasingly complex accounting standards. Our plans at this time include providing enhanced access to accounting literature, research materials and documents and increased communication among our legal and finance personnel and third party professionals with whom we consult regarding complex accounting applications. The elements of our remediation plan can only be accomplished over time and we can offer no assurance that these initiatives will ultimately have the intended effects.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not aware of any pending or threatened legal actions that would, if determined adversely to us, have a material adverse effect on our business and operations.

We have from time to time been involved in disputes and proceedings arising in the ordinary course of business, including in connection with the conduct of our clinical trials. In addition, as a public company, we are also potentially susceptible to litigation, such as claims asserting violations of securities laws. Any such claims, with or without merit, if not resolved, could be time-consuming and result in costly litigation. There can be no assurance that an adverse result in any future proceeding would not have a potentially material adverse effect on our business, results of operations and financial condition.

ITEM 1A. RISK FACTORS

In addition to the risks, uncertainties and other factors discussed in this Quarterly Report on Form 10-Q, *see* the risks and uncertainties discussed in our 2009 Form 10-K and our 2009 Form 10-K/A-1, including the "Risk Factors" section contained in our 2009 Form 10-K.

As we are unable to regain compliance with the Minimum Bid Price Requirement of The Nasdaq Capital Market® prior to November 29, 2010, we will be forced to seek a hearing and submit a plan for regaining compliance. As a result, our stock price may decline and, following a hearing, our common stock may delisted from the Nasdaq Capital Market. If our stock is no longer listed on Nasdaq Capital Market, the liquidity of our securities would be impaired.

On December 2, 2009, we received a letter from The NASDAQ Global Market® (Global Market) indicating that for 30 consecutive business days our common stock did not maintain a minimum closing bid price of $1.00 per share as required by Nasdaq Listing Rule 5450(a)(1) (Minimum Bid Price Rule). Under the Nasdaq Listing Rules, if during the 180 calendar days following the date of the notification, or prior to June 1, 2010, the closing bid price of our stock did not rise above $1.00 for a minimum of 10 consecutive business days, we would be subject to delisting from the Global Market.

In May 2010, we anticipated that we would not regain compliance with the Minimum Bid Price Rule on or before June 1, 2010 and filed an application to transfer the listing of our common stock from the Global Market to The Nasdaq Capital Market, which was effective at the opening of the market on June 4, 2010. Our common stock currently trades on the Nasdaq Capital Market under the symbol DSCO and the transfer has had no impact on the ability of investors to trade the stock. The Nasdaq Capital Market is a continuous trading market that operates in the same manner as The Global Market. All companies listed on the Nasdaq Capital Market must meet certain financial requirements and adhere to Nasdaq's corporate governance standards.

Also on June 2, 2010, based on our ability to comply with all listing requirements of the Nasdaq Capital Market other than the Minimum Bid Price Rule, we received a written notification from Nasdaq granting us an additional 180 days, or until November 29, 2010, to regain compliance with the Minimum Bid Price Rule. Under the Nasdaq Listing Rules, if prior to November 29, 2010, the closing bid price of our stock is at or above $1.00 for a minimum of 10 consecutive business days, we will regain compliance with the Minimum Bid Price Rule and our common stock will continue to be eligible for listing on the Nasdaq Capital Market.

As we will not achieve compliance with the Minimum Bid Price Rule by November 29, 2010, we expect that Nasdaq will provide us with written notification that our common stock is subject to delisting. Currently, we plan to request a hearing with a Nasdaq Hearing Panel, which if granted, would stay delisting pending the hearing. At the hearing, we will present a plan for regaining compliance with the Minimum Bid Price Rule. We have presented to our stockholders, for approval at our 2010 Annual Meeting of Stockholders on December 21, 2010, a proposal to authorize our Board, in its sole discretion, to effect a share consolidation, or reverse stock split (reverse split) of our common stock, at a ratio of 1-for-15, on the terms described in the Proxy Statement. If a reverse split is approved by our stockholders, our plan to regain compliance may include a reverse split.

If the Nasdaq Panel determines that we can continue to list our common Stock on the Nasdaq Capital Market following implementation of a reverse split, our Board will weigh the benefits of continued listing on the Nasdaq Capital Market, the potential adverse impact of a reverse split and the perceived weaknesses of the OTC Bulletin Board. At the present time, our Board believes that the benefits of continuing our listing on the Nasdaq Capital Market outweigh the risks associated with implementing a reverse split. However, the Board will not implement a reverse split or a reduction in the number of authorized shares of Common Stock if it determines at any time that a reverse split would not be in our best interests or that of our stockholders.

If our common stock were delisted from the Nasdaq Capital Market, it would then be eligible for quotation on the OTC Bulletin Board® of the Financial Industry Regulatory Authority, Inc. (FINRA) or the over-the-counter market in the Pink Sheets® (a quotation medium operated by Pink OTC Markets Inc.). This would impair the liquidity of our securities not only in the number of shares that could be bought and sold at a given price, which might be depressed by the relative illiquidity, but also through delays in the timing of transactions and reduction in media coverage. As a result, an investor might find it more difficult to dispose of, or to obtain accurate quotations as to the market value of, our common stock. We have been advised that current and prospective investors will view an investment in our common stock more favorably if our Common Stock is listed on the Nasdaq Capital Market than if it is traded on the OTC Bulletin Board.

We depend upon key employees and consultants in a competitive market for skilled personnel. If we are unable to attract and retain key personnel, it could adversely affect our ability to develop and market our products.

We are highly dependent upon the members of our executive management team and our directors, as well as our scientific advisory board members, consultants and collaborating scientists. Many of these people have been involved with us for many years, have played integral roles in our progress and we believe that they continue to provide value to us. A loss of any of our key personnel may have a material adverse effect on aspects of our business and clinical development and regulatory programs.

Following the resignation of our former President and Chief Executive Officer and a member of our Board of Directors in August 2009, our Board elected W. Thomas Amick, our Chairman of the Board, to act as Chief Executive Officer on an interim basis. This arrangement was extended through June 30, 2011. In October, Mr. Amick joined our company on a full-time basis as Chief Executive Officer. Until October, Mr. Amick was otherwise employed by another biotech company as its Chief Executive Officer, and was able to devote only a portion of his time to his duties as our interim Chief Executive Officer.

As of September 30, 2010, we had employment agreements with four executive officers, including: President and Chief Financial Officer and Treasurer; Executive Vice President, General Counsel and Secretary; Chief Operating Officer; and Senior Vice President, Human Resources, that expire in May 2011. As of October 18, 2010, we entered into an executive employment agreement with Mr. Amick, our Chief Executive Officer, which expires in October 2011. These agreements provide for automatic one-year renewal at the end of each term, unless otherwise terminated by either party. In addition, in May 2010, we entered into retention agreements with five other officers under which each officer is provided certain severance benefits, based on title. While we believe that our executive benefits are sufficient to attract and retain executive management, as the economic environment in our market improves, we face intense competition for our executives. In July, our Senior Vice President, Quality, resigned his position with us and accepted a position with another biotech company. In September 2010, Charles Katzer, our Chief Technology Officer resigned his position with us and accepted another position. The loss of services from any of our remaining executives could significantly adversely affect our ability to develop and market our products and obtain necessary regulatory approvals. Further, we do not maintain key-man life insurance.

We expect that, once we have secured sufficient strategic and financial resources to support our operations, including the continuing development of our KL_4 surfactant technology, we will seek to attract candidates to join our management and development teams, although there can be no assurances that we will be successful in that endeavor. Moreover, although our executive employment agreements with our five senior officers generally include non-competition covenants and provide for severance payments that are contingent upon the applicable employee's refraining from competition with us, the applicable noncompete provisions can be difficult and costly to monitor and enforce, such that we may not be successful in retaining these individuals and, if any should resign, in enforcing our noncompetition agreements with them.

Our future success also will depend in part on the continued service of our key scientific and management personnel and our ability to identify, hire and retain additional personnel. While we attempt to provide competitive compensation packages to attract and retain key personnel at all levels in our organization, many of our competitors have greater resources and more experience than we, making it difficult for us to compete successfully for key personnel. We may experience intense competition for qualified personnel and the existence of non-competition agreements between prospective employees and their former employers may prevent us from hiring those individuals or subject us to lawsuits brought by their former employers.

The restatement of our historical financial statements has already consumed a significant amount of our time and resources and may have a material adverse effect on our business and stock price.

As described earlier, we have restated our consolidated financial statements for the periods ended beginning June 30, 2009 through June 30, 2010. The restatement process was highly time and resource-intensive and involved substantial attention from management and significant legal and accounting costs. Although we have now completed the restatements, we cannot guarantee that we will have no inquiries from the SEC or the Nasdaq Capital Market regarding our restated financial statements or matters relating thereto.

Any future inquiries from the SEC as a result of the restatement of our historical financial statements will, regardless of the outcome, likely consume a significant amount of our resources in addition to those resources already consumed in connection with the restatement itself.

Further, many companies that have been required to restate their historical financial statements have experienced a decline in stock price and stockholder lawsuits related thereto.

If we fail to maintain an effective system of internal control over financial reporting, we may not be able to accurately report our financial results, and current and potential stockholders may lose confidence in our financial reporting.

We are required by the SEC to establish and maintain adequate internal control over financial reporting that provides reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles. We are likewise required, on a quarterly basis, to evaluate the effectiveness of our internal controls and to disclose any changes and material weaknesses in those internal controls.

As described elsewhere in this Quarterly Report on Form 10-Q, in connection with the restatement process, we identified a material weakness in our internal control regarding our process and procedures related to the initial classification and subsequent accounting of registered warrants as liabilities or equity instruments dating back to May 2009. Upon a reassessment of those financial instruments, in light of GAAP as currently interpreted, we determined that we should have accounted for registered warrants that we issued in May 2009 and February 2010 as derivative liabilities instead of equity. Given this material weakness, management was unable to conclude that we maintained effective internal control over financial reporting as of September 30, 2010.

To respond to the material weakness, we plan to devote significant effort and resources to the remediation and improvement of our internal control over financial reporting. While we have processes to identify and intelligently apply developments in accounting, we plan to enhance these processes to better evaluate our research and understanding of the nuances of increasingly complex accounting standards. Our plans at this time include providing enhanced access to accounting literature, research materials and documents and increased communication among our legal and finance personnel and third party professionals with whom we consult regarding complex accounting applications. The elements of our remediation plan can only be accomplished over time and we can offer no assurance that these initiatives will ultimately have the intended effects.

Any failure to maintain such internal controls could adversely impact our ability to report our financial results on a timely and accurate basis. If our financial statements are not accurate, investors may not have a complete understanding of our operations. Likewise, if our financial statements are not filed on a timely basis as required by the SEC and Nasdaq, we could face severe consequences from those authorities. In either case, there could result a material adverse affect on our business. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our stock. We can give no assurance that the measures we have taken and plan to take in the future will remediate the material weaknesses identified or that any additional material weaknesses or restatements of financial results will not arise in the future due to a failure to implement and maintain adequate internal control over financial reporting or circumvention of these controls. In addition, even if we are successful in strengthening our controls and procedures, in the future those controls and procedures may not be adequate to prevent or identify irregularities or errors or to facilitate the fair presentation of our consolidated financial statements.

If a reverse split is effected, the total value of our outstanding shares (market capitalization) immediately after a reverse split may be lower than immediately before a reverse split. Moreover, a decline in the market price of our common stock after a reverse split may result in a greater percentage decline than would occur in the absence of a reverse split.

As noted above, we have presented to our stockholders, for approval at our 2010 Annual Meeting of Stockholders on December 21, 2010, a proposal to authorize our Board, in its sole discretion, to effect a share consolidation, or reverse stock split (reverse split) of our common stock, at a ratio of 1-for-15, on the terms described in the Proxy Statement. In that regard, there are numerous risks and uncertainties that could affect the value of our common stock after a reverse split. In addition to risks and uncertainties related directly to our company, including without limitation, the status of our research and development programs, our cash position and reported results of operations in future periods, and our ability to attract and retain key executive management and professional personnel, other factors include market conditions as a whole and the general economic environment. In addition, reverse splits that are effected to regain compliance with the Minimum Bid Price Rule are generally viewed negatively by many investors, analysts and institutions. Even though a reverse split would have no impact on our capital, cash position, financial condition, or the number of our stockholders, our research suggests that, with the announcement and after implementation of a reverse split, there is reverse-split-related trading activity that may have the effect of depressing the market price of our common stock and our market capitalization. Thus, although a reverse split may support continued listing of our common stock on the Nasdaq Capital Market, implementing a reverse split could adversely affect our market value and make it more difficult to finance our activities.

For these reasons, if the Board implements a reverse split, the market price of our common stock will likely not be sustainable at the arithmetic result obtained by applying the ratio of the reverse stock split by the market price of our stock immediately prior to the announcement of a reverse split, and the percentage decline in our market value may be greater than would occur in the absence of a reverse split. If the market price of our common stock declines after the reverse split, our total market capitalization (the aggregate value of all of our outstanding common stock at the then existing market price) after the split will be lower than before the split.

If the value of our common stock is reduced following a reverse split below the minimum price permitted under our Committed Equity Financing Facilities ("CEFFs"), we will be unable to access our CEFFs. In that event, we may be unable to fund our activities, which would have a material adverse effect on our operations.

Except for our CEFFs (which are subject to certain limitations), we currently do not have arrangements to obtain additional financing. If we are unable to meet the conditions provided under the CEFFs, we will not be able to issue any portion of the shares potentially available for issuance under the CEFFs to fund our activities and the CEFFs may expire. If we are otherwise unable to successfully raise sufficient additional capital, through strategic alliances and other financing alternatives, we will likely not have sufficient cash flow and liquidity to fund our business operations, forcing us to curtail our activities and, ultimately, potentially cease operations. Even if we are able to raise additional capital, such financings may only be available on unattractive terms, or could result in significant dilution of stockholders' interests and, in that event, the market price of our common stock may decline further.

If a reverse split is effected, there is no assurance that we will be able to comply with the continued listing requirements of the Nasdaq Capital Market, which may result in our common stock being delisted even after implementing a reverse split.

If the Board determines that a reverse split is in our best interests and that of our stockholders, the Board will set the ratio with the intent of raising the price per share of our common stock above $1.00 to comply with Nasdaq's Minimum Bid Price Rule. However, there is no assurance that after the reverse split is completed, our common stock will maintain its reverse split adjusted price. As a result, our stock price could trade below the required $1.00 minimum bid price and we may not regain or maintain compliance with the Nasdaq Capital Market listing requirements. Moreover if trading activity following a reverse split has the effect of reducing the total market capitalization of our company, we may be unable to fund our activities, resulting in reductions in our stockholders' equity. In addition to a minimum bid price, other Nasdaq continued listing requirements require that we maintain a market capitalization of at least $35 million and stockholders' equity of at least $2.5 million. If we are unable to meet these requirements following a reverse split, the reverse split may not achieve its intended purpose and we would nevertheless receive a delisting notice from the Nasdaq Capital Market for failure to comply with one or more of the continued listing requirements.

If effected, a reverse split may reduce liquidity and increase volatility of our common stock.

Our stock historically has traded at relatively high average volumes, which often produces pricing efficiencies. Following a reverse split, the number of shares available for trading in the public market will be reduced by a factor of 15. The reduction in shares could result in reduced trading activity, fewer market makers and less interest in our stock. This could result in increased volatility and adversely affect liquidity of our common stock.

The market price of our common stock following a reverse split may not generate increased interest in our common stock by institutional investors, investment funds or broker dealers and may not satisfy the investing guidelines of such investors and, consequently, the trading liquidity of our common stock may not improve.

Although we believe that a higher per-share market value may help generate increased interest in our common stock, there can be no assurance that a reverse split in the range proposed would generate any increased interest in our common stock, by institutional investors, investment funds, advisors or broker dealers. As a result, the trading liquidity of our common stock may not necessarily improve following a reverse split.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the three and nine months ended September 30, 2010, we did not issue any unregistered shares of common stock. There were no stock repurchases during the three and nine months ended September 30, 2010.

ITEM 6. EXHIBITS

Exhibits are listed on the Index to Exhibits at the end of this Quarterly Report. The exhibits required by Item 601 of Regulation S-K, listed on such Index in response to this Item, are incorporated herein by reference.

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 thereunto duly authorized.

Discovery Laboratories, Inc.
(Registrant)

Date: November 15, 2010

By: /s/ W. Thomas Amick
W. Thomas Amick, Chairman of the Board and
Chief Executive Officer (Principal Executive Officer)

Date: November 15, 2010

By: /s/ John G. Cooper
John G. Cooper
President and Chief Financial Officer (Principal
Financial Officer)

INDEX TO EXHIBITS

The following exhibits are included with this Quarterly Report on Form 10-Q.

Exhibit No.	Description	Method of Filing
3.1	Amended and Restated Certificate of Incorporation of Discovery Laboratories, Inc. (Discovery), dated December 9, 2009.	Incorporated by reference to Exhibit 3.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on December 9, 2009.
3.2	Certificate of Designations, Preferences and Rights of Series A Junior Participating Cumulative Preferred Stock of Discovery, dated February 6, 2004.	Incorporated by reference to Exhibit 2.2 to Discovery's Form 8-A, as filed with the SEC on February 6, 2004.
3.3	Amended and Restated By-Laws of Discovery, as amended effective September 3, 2009.	Incorporated by reference to Exhibit 3.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on September 4, 2009
4.1	Shareholder Rights Agreement, dated as of February 6, 2004, by and between Discovery and Continental Stock Transfer & Trust Company.	Incorporated by reference to Exhibit 10.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on February 6, 2004.
4.2	Form of Class A Investor Warrant.	Incorporated by reference to Exhibit 4.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on June 20, 2003.
4.3	Class C Investor Warrant, dated April 17, 2006, issued to Kingsbridge Capital Limited	Incorporated by reference to Exhibit 4.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on April 21, 2006.
4.4	Warrant Agreement, dated November 22, 2006 by and between Discovery and Capital Ventures International	Incorporated by reference to Exhibit 4.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on November 22, 2006.
4.5	Warrant Agreement dated May 22, 2008 by and between Kingsbridge Capital Limited and Discovery.	Incorporated by reference to Exhibit 4.1 to Discovery's Current Report on Form 8-K as filed with the SEC on May 28, 2008.
4.6	Warrant Agreement dated December 12, 2008 by and between Kingsbridge Capital Limited and Discovery.	Incorporated by reference to Exhibit 4.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on December 15, 2008.
4.7	Form of Stock Purchase Warrant issued in May 2009	Incorporated by reference to Exhibit 10.3 to Discovery's Current Report on Form 8-K, as filed with the SEC on May 8, 2009.
4.8	Form of Stock Purchase Warrant issued in February 2010	Incorporated by reference to Exhibit 4.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on February 18, 2010.
4.9	Warrant Agreement, dated as of April 30, 2010, by and between Discovery and PharmaBio	Incorporated by reference to Exhibit 4.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on April 28, 2010.

Exhibit No.	Description	Method of Filing
4.10	Warrant Agreement dated June 11, 2010 by and between Kingsbridge Capital Limited and Discovery.	Incorporated by reference to Exhibit 4.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on June 14, 2010.
4.11	Form of Five-Year Warrant dated June 22, 2010	Incorporated by reference to Exhibit 4.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on June 17, 2010.
4.12	Form of Short-Term Warrant dated June 22, 2010	Incorporated by reference to Exhibit 4.2 to Discovery's Current Report on Form 8-K, as filed with the SEC on June 17, 2010.
4.13	Warrant Agreement, dated as of April 30, 2010, by and between Discovery and PharmaBio	Incorporated by reference to Exhibit 4.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on April 28, 2010.
4.14	Warrant Agreement, dated as of October 12, 2010, by and between Discovery and PharmaBio	Incorporated by reference to Exhibit 4.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on October 13, 2010.
10.1*	Renewal of Interim CEO Agreement dated July 2, 2010 between W. Thomas Amick and Discovery.	Incorporated by reference to Exhibit 10.8 to Discovery's Quarterly Report on Form 10-Q dated June 30, 2010, as filed with the SEC on August 9, 2010.
10.2*	Form of Restricted Stock Award Agreement	Incorporated by reference to Exhibit 10.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on October 1, 2010.
10.3	Securities Purchase Agreement dated October 12, 2010 by and between PharmaBio and Discovery	Incorporated by reference to Exhibit 10.1 to Discovery's Current Report on Form 8-K, as filed with the SEC on October 13, 2010.
10.4*	Employment Agreement dated as of October 18, 2010 by and between W. Thomas Amick and Discovery	Filed herewith
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) of the Exchange Act.	Filed herewith.
31.2	Certification of Chief Financial Officer and Principal Accounting Officer pursuant to Rule 13a-14(a) of the Exchange Act.	Filed herewith.
32.1	Certification of Principal Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed herewith.

* A management contract or compensatory plan or arrangement required to be filed as an exhibit to this annual report pursuant to Item 15(b) of Form 10-K.

EMPLOYMENT AGREEMENT

This Employment Agreement (the "Agreement") is made as of this 18th day of October, 2010, by and between DISCOVERY LABORATORIES, INC., a Delaware corporation (the "Company"), and W. Thomas Amick (the "Executive").

WHEREAS, the Company and Executive desire that Executive be employed by the Company to act as the Company's Chief Executive Officer and that the terms and conditions of such employment be defined.

NOW, THEREFORE, in consideration of the covenants contained herein, and for other valuable consideration, the Company and the Executive hereby agree as follows:

1. Certain Definitions. Certain definitions used herein shall have the meanings set forth on Exhibit A attached hereto.

2. Term of the Agreement. The term ("Term") of this Agreement shall commence on the date first above written and shall continue through October 17, 2011; provided, however, that commencing on October 18, 2011 and on each October 18th thereafter, the term of this Agreement shall automatically be extended for one additional year, unless at least 90 days prior to such October 18th date, the Company or the Executive shall have given notice that it does not wish to extend this Agreement. Upon the occurrence of a Change of Control during the term of this Agreement, including any extensions thereof, this Agreement shall automatically be extended until the end of the Effective Period if the end of the Effective Period is after the then current expiration date of the Term. Notwithstanding the foregoing, this Agreement shall terminate prior to the scheduled expiration date of the Term on the Date of Termination.

3. Executive's Duties and Obligations.

(a) Duties. The Executive shall serve as the Company's Chief Executive Officer. The Executive shall be responsible for all duties customarily associated with this title, including without limitation, activities regarding (i) day-to-day operational affairs; (ii) the development and commercialization of the Company's products; (iii) proposed strategic alliances, joint ventures, partnerships and other potential collaborations; and (iv) all other appropriate functions for the Company. The Executive shall at all times report to, and shall be subject to the policies established by the Board and any executive committee thereof (the "Executive Committee").

(b) Location of Employment. The Executive's principal place of business shall be at the Company's headquarters to be located within thirty (30) miles of Doylestown, Pennsylvania; provided, that the Executive acknowledges and agrees that the performance by the Executive of his duties shall require frequent travel including, without limitation, overseas travel from time to time.

(c) Proprietary Information and Inventions Matters. In consideration of the covenants contained herein, the Executive hereby agrees to execute the Company's standard form of Proprietary Information and Inventions Agreement (the "Confidentiality Agreement"), a copy of which is attached to this Agreement as Exhibit B. The Executive shall comply at all times with the terms and conditions of the Confidentiality Agreement and all other reasonable policies of the Company governing its confidential and proprietary information.

4. Devotion of Time to Company's Business.

(a) Full-Time Efforts. During his employment with the Company, the Executive shall devote substantially all of his time, attention and efforts to the proper performance of his implicit and explicit duties and obligations hereunder to the reasonable satisfaction of the Company.

(b) No Other Employment. During his employment with the Company, the Executive shall not, except as otherwise provided herein, directly or indirectly, render any services of a commercial or professional nature to any other person or organization, whether for compensation or otherwise, without the prior written consent of the Executive Committee or the Board.

(c) Non-Competition During and After Employment. During the Term and for 12 months from the Date of Termination, the Executive shall not, directly or indirectly, without the prior written consent of the Company, either as an employee, employer, consultant, agent, principal, partner, stockholder, corporate officer, director, or in any other individual or representative capacity (X) compete with the Company in the business of developing or commercializing pulmonary surfactants or any other category of compounds which forms the basis of the Company's material products or any material products under development on the Date of Termination, or (Y) solicit, encourage, induce or endeavor to entice away from the Company, or otherwise interfere with the relationship of the Company with, any person who is employed or engaged by the Company as an employee, consultant or independent contractor or who was so employed or engaged at any time during the preceding six (6) months; provided, that nothing herein shall prevent the Executive from engaging in discussions regarding employment, or employing, any such employee, consultant or independent contractor (i) if such person shall voluntarily initiate such discussions without any such solicitation, encouragement, enticement or inducement prior thereto on the part of the Executive or (ii) if such discussions shall be held as a result of or employment be the result of the response by any such person to a written employment advertisement placed in a publication of general circulation, general solicitation conducted by executive search firms, employment agencies or other general employment services, not directed specifically at any such employee, consultant or independent contractor.

(d) Injunctive Relief. In the event that the Executive breaches any provisions of Section 4(c) or of the Confidentiality Agreement or there is a threatened breach thereof, then, in addition to any other rights which the Company may have, the Company shall be entitled, without the posting of a bond or other security, to injunctive relief to enforce the restrictions contained therein. In the event that an actual proceeding is brought in equity to enforce the provisions of Section 4(c) or the Confidentiality Agreement, the Executive shall not urge as a defense that there is an adequate remedy at law nor shall the Company be prevented from seeking any other remedies which may be available.

(e) Reformation. To the extent that the restrictions imposed by Section 4(c) are interpreted by any court to be unreasonable in geographic and/or temporal scope, such restrictions shall be deemed automatically reduced to the extent necessary to coincide with the maximum geographic and/or temporal restrictions deemed by such court not to be unreasonable.

5. Compensation and Benefits.

(a) Base Compensation. During the Term, the Company shall pay to the Executive (i) base annual compensation ("Base Salary") of at least $400,000, payable in accordance with the Company's regular payroll practices and less all required withholdings and (ii) additional compensation, if any, and benefits as hereinafter set forth in this Section 5. The Base Salary shall be reviewed at least annually for the purposes of determining increases, if any, based on the Executive's performance, the performance of the Company, inflation, the then prevailing salary scales for comparable positions and other relevant factors; provided, however, that any such increase in Base Salary shall be solely within the discretion of the Company.

(b) Bonuses. During the Term, the Executive shall be eligible for such year-end bonus, which may be paid in either cash or equity, or both, as is awarded solely at the discretion of the Compensation Committee of the Board after consultation with the Company's Chief Executive Officer, provided, that the Company shall be under no obligation whatsoever to pay such discretionary year-end bonus for any year.

(c) Benefits. During the Term, the Executive shall be entitled to participate in all employee benefit plans, programs and arrangements made available generally to the Company's senior executives or to its employees on substantially the same basis that such benefits are provided to such executives or employees (including, without limitation profit-sharing, savings and other retirement plans (e.g., a 401(k) plan) or programs, medical, dental, hospitalization, vision, short-term and long-term disability and life insurance plans or programs, accidental death and dismemberment protection, travel accident insurance, and any other employee welfare benefit plans or programs that may be sponsored by the Company from time to time, including any plans or programs that supplement the above-listed types of plans or programs, whether funded or unfunded); provided, however, that nothing in this Agreement shall be construed to require the Company to establish or maintain any such plans, programs or arrangements. Anything contained herein to the contrary notwithstanding, throughout the Term, Executive shall be entitled to receive life insurance on behalf of Executive's named beneficiaries in the amount of Executive's then current annual salary for the Term of this Agreement at no cost to the Executive, except the Company shall have no liability whatsoever for any taxes (whether based on income or otherwise) imposed upon or incurred by Executive in connection with any such insurance.

(d) Vacations. During the Term, the Executive shall be entitled to 20 days paid vacation per year, to be earned ratably throughout the year, 5 days of which may be carried over from year to year (provided, that in no event shall the aggregate number of such vacation days carried over to any succeeding year exceed 10 days).

(e) Reimbursement of Business Expenses. The Executive is authorized to incur reasonable expenses in carrying out his duties and responsibilities under this Agreement and the Company shall reimburse him for all such expenses, in accordance with reasonable policies of the Company.

6. Change of Control Benefits.

(a) Bonus. The Executive shall be awarded an annual cash bonus for each fiscal year of the Company ending during the Effective Period at least equal to the Highest Annual Bonus.

(b) Options. Notwithstanding any provision to the contrary in the Company's 2007 Long Term Incentive Plan or any stock option or restricted stock agreement between the Company and the Executive, all shares of stock and all options to acquire Company stock held by the Executive shall accelerate and become fully vested and, with respect to restricted stock, all restrictions shall be lifted upon the Change of Control Date. In the case of any Change of Control in which the Company's common stockholders receive cash, securities or other consideration in exchange for, or in respect of, their Company common stock, (i) the Executive shall be permitted to exercise his options at a time and in a fashion that will entitle him to receive, in exchange for any shares acquired pursuant to any such exercise, the same per share consideration as is received by the other holders of the Company's common stock, and (ii) if the Executive shall elect not to exercise all or any portion of such options, any such unexercised options shall terminate and cease to be outstanding following such Change of Control, except to the extent assumed by a successor corporation (or its parent) or otherwise expressly continued in full force and effect pursuant to the terms of such Change of Control.

7. Termination of Employment.

(a) Termination by the Company for Cause or Termination by the Executive without Good Reason, Death or Disability.

(i) In the event of a termination of the Executive's employment by the Company for Cause, a termination by the Executive without Good Reason, or in the event this Agreement terminates by reason of the death or Disability of the Executive, the Executive shall be entitled to any unpaid compensation accrued through the last day of the Executive's employment, a lump sum payment in respect of all accrued but unused vacation days (provided, that in no event shall the aggregate number of such accrued vacation days exceed 10 days) at his Base Salary in effect on the date such vacation was earned, and payment of any other amounts owing to the Executive but not yet paid. The Executive shall not be entitled to receive any other compensation or benefits from the Company whatsoever (except as and to the extent the continuation of certain benefits is required by law).

(ii) In the case of a termination due to death or disability, notwithstanding any provision to the contrary in any stock option or restricted stock agreement between the Company and the Executive, all shares of stock and all options to acquire Company stock held by the Executive shall accelerate and become fully vested upon the Date of Termination (and all options shall thereupon become fully exercisable), and all stock options shall continue to be exercisable for the remainder of their stated terms.

(b) Termination by the Company without Cause or by the Executive for Good Reason. If (x) the Executive's employment is terminated by the Company other than for Cause, death or Disability (i.e., without Cause) or (y) the Executive terminates employment with Good Reason, then the Executive shall be entitled to receive the following from the Company:

(i) The amounts set forth in Section 7(a)(i);

(ii) Within 10 days after the Date of Termination, a lump sum cash payment equal to the Highest Annual Bonus multiplied by the fraction obtained by dividing the number of days in the year through the Date of Termination by 365;

(iii) Within 10 days after the Date of Termination, a lump sum cash payment in an amount equal to one and a half (1.5) times the sum of (A) the Executive's Base Salary then in effect (determined without regard to any reduction in such Base Salary constituting Good Reason) and (B) the Highest Annual Bonus;

(iv) For one and a half years from the Date of Termination, the Company shall either (A) arrange to provide the Executive and his dependents, at the Company's cost (except to the extent such cost was borne by the Executive prior to the Date of Termination, and further, to the extent that such post-termination coverages are available under the Company's plans), with life, disability, medical and dental coverage, whether insured or not insured, providing substantially similar benefits to those which the Executive and his dependents were receiving immediately prior to the Date of Termination, or (B) in lieu of providing such coverage, pay to the Executive no less frequently than quarterly in advance an amount which, after taxes, is sufficient for the Executive to purchase equivalent benefits coverage referred to in clause (A); provided, however, that the Company's obligation under this Section 7(b)(iv) shall be reduced to the extent that substantially similar coverages (determined on a benefit-by-benefit basis) are provided by a subsequent employer;

(v) Notwithstanding any provision to the contrary in any stock option or restricted stock agreement between the Company and the Executive, all shares of stock and all options to acquire Company stock held by the Executive shall accelerate and become fully vested upon the Date of Termination (and all options shall thereupon become fully exercisable), and all stock options shall continue to be exercisable for the remainder of their stated terms;

(vi) Any other additional benefits then due or earned in accordance with applicable plans and programs of the Company; and

(vii) The Company will provide out-placement counseling assistance in the form of reimbursement of the reasonable expenses incurred for such assistance within the 12-month period following the Date of Termination. Such reimbursement amount shall not exceed $40,000.

(c) Termination in connection with a Change of Control. If the Executive's employment is terminated by the Company other than for Cause or by the Executive for Good Reason during the Effective Period, then the Executive shall be entitled to receive the following from the Company:

(i) All amounts and benefits described in Section 7(a)(i) above;

(ii) Within 10 days after the Date of Termination, a lump sum cash payment equal to the Highest Annual Bonus multiplied by the fraction obtained by dividing the number of days in the year through the Date of Termination by 365;

(iii) Within 10 days after the Date of Termination, a lump sum cash payment in an amount equal to the product of two and a half (2.5) times the sum of (A) the Executive's Base Salary then in effect (determined without regard to any reduction in such Base Salary constituting Good Reason) and (B) the Highest Annual Bonus;

(iv) For two and a half years from the Date of Termination, the Company shall either (A) arrange to provide the Executive and his dependents, at the Company's cost (except to the extent such cost was borne by the Executive prior to the Date of Termination, and further, to the extent that such post-termination coverages are available under the Company's plans), with life, disability, medical and dental coverage, whether insured or not insured, providing substantially similar benefits to those which the Executive and his dependents were receiving immediately prior to the Date of Termination, or (B) in lieu of providing such coverage, pay to the Executive no less frequently than quarterly in advance an amount which, after taxes, is sufficient for the Executive to purchase equivalent benefits coverage referred to in clause (A); provided, however, that the Company's obligation under this Section 7(c)(iv) shall be reduced to the extent that substantially similar coverages (determined on a benefit-by-benefit basis) are provided by a subsequent employer;

(v) Notwithstanding any provision to the contrary in any stock option or restricted stock agreement between the Company and the Executive, all shares of stock and all options to acquire Company stock held by the Executive shall accelerate and become fully vested upon the Date of Termination (and all options shall thereupon become fully exercisable), and all stock options shall continue to be exercisable for the remainder of their stated terms;

(vi) Any other additional benefits then due or earned in accordance with applicable plans and programs of the Company; and

(vii) The Company will provide out-placement counseling assistance in the form of reimbursement of the reasonable expenses incurred for such assistance within the 12-month period following the Date of Termination. Such reimbursement amount shall not exceed $40,000.

8. Notice of Termination.

(a) Any termination of the Executive's employment by the Company for Cause, or by the Executive for Good Reason shall be communicated by a Notice of Termination to the other party hereto given in accordance with Section 12. For purposes of this Agreement, a "Notice of Termination" means a written notice which: (i) is given at least 10 days prior to the Date of Termination, (ii) indicates the specific termination provision in this Agreement relied upon, (iii) to the extent applicable, sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of the Executive's employment under the provision so indicated, and (iv) specifies the employment termination date. The failure to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of Good Reason or Cause will not waive any right of the party giving the Notice of Termination hereunder or preclude such party from asserting such fact or circumstance in enforcing its rights hereunder.

(b) A Termination of Employment of the Executive will not be deemed to be for Good Reason unless the Executive gives the Notice of Termination provided for herein within 12 months after the Executive has actual knowledge of the act or omission of the Company constituting such Good Reason.

9. Mitigation of Damages. The Executive will not be required to mitigate damages or the amount of any payment or benefit provided for under this Agreement by seeking other employment or otherwise. Except as otherwise provided in Sections 7(b)(iv) and 7(c)(iv), the amount of any payment or benefit provided for under this Agreement will not be reduced by any compensation or benefits earned by the Executive as the result of self-employment or employment by another employer or otherwise.

10. Excise Tax Gross-Up.

(a) Anything in this Agreement to the contrary notwithstanding, in the event it shall be determined that any payment, award, benefit or distribution (including any acceleration) by the Company or any entity which effectuates a transaction described in Section 280G(b)(2)(A)(i) of the Code to or for the benefit of the Executive (whether pursuant to the terms of this Agreement or otherwise, but determined without regard to any additional payments required under this Section 10) (a "Payment") would be subject to the excise tax imposed by Section 4999 of the Code or any interest or penalties are incurred with respect to such excise tax by the Executive (such excise tax, together with any such interest and penalties, are hereinafter collectively referred to as the "Excise Tax"), then the Executive shall be entitled to receive an additional payment (a "Gross-Up Payment") in an amount such that after payment by the Executive of all taxes, including, without limitation, any income taxes (and any interest and penalties imposed with respect thereto) and Excise Taxes imposed upon the Gross-Up Payment, the Executive retains an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payments. For purposes of this Section 10, the Executive shall be deemed to pay federal, state and local income taxes at the highest marginal rate of taxation for the calendar year in which the Gross Up Payment is to be made, taking into account the maximum reduction in federal income taxes which could be obtained from the deduction of state and local income taxes.

(b) All determinations required to be made under this Section 10, including whether and when a Gross-Up Payment is required and the amount of such Gross-Up Payment and the assumptions to be utilized in arriving at such determination, shall be made by the Company's independent auditors or such other certified public accounting firm of national standing reasonably acceptable to the Executive as may be designated by the Company (the "Accounting Firm") which shall provide detailed supporting calculations both to the Company and the Executive within 15 business days of the receipt of notice from the Executive that there has been a Payment, or such earlier time as is requested by the Company. All fees and expenses of the Accounting Firm shall be borne solely by the Company. Any Gross-Up Payment, as determined pursuant to this Section 10, shall be paid by the Company to the Executive within five days of the later of (i) the due date for the payment of any Excise Tax, and (ii) the receipt of the Accounting Firm's determination. If the Accounting Firm determines that no Excise Tax is payable by the Executive, it shall furnish the Executive with a written opinion to such effect, and to the effect that failure to report the Excise Tax, if any, on the Executive's applicable federal income tax return will not result in the imposition of a negligence or similar penalty. Any determination by the Accounting Firm shall be binding upon the Company and the Executive. As a result of the uncertainty in the application of Section 4999 of the Code at the time of the initial determination by the Accounting Firm hereunder, it is possible that Gross-Up Payments which will not have been made by the Company should have been made ("Underpayment") or Gross-up Payments are made by the Company which should not have been made ("Overpayments"), consistent with the calculations required to be made hereunder. In the event the Executive is required to make a payment of any Excise Tax, the Accounting Firm shall determine the amount of the Underpayment that has occurred and any such Underpayment shall be promptly paid by the Company to or for the benefit of the Executive. In the event the amount of Gross-up Payment exceeds the amount necessary to reimburse the Executive for his Excise Tax, the Accounting Firm shall determine the amount of the Overpayment that has been made and any such Overpayment shall be promptly paid by the Executive (to the extent he has received a refund if the applicable Excise Tax has been paid to the Internal Revenue Service) to or for the benefit of the Company. The Executive shall cooperate, to the extent his expenses are reimbursed by the Company, with any reasonable requests by the Company in connection with any contests or disputes with the Internal Revenue Service in connection with the Excise Tax.

11. Legal Fees. All reasonable legal fees and related expenses (including costs of experts, evidence and counsel) paid or incurred by the Executive pursuant to any claim, dispute or question of interpretation relating to this Agreement shall be paid or reimbursed by the Company if the Executive is successful on the merits pursuant to a legal judgment or arbitration. Except as provided in this Section 11, each party shall be responsible for its own legal fees and expenses in connection with any claim or dispute relating to this Agreement.

12. Notices. All notices, requests, demands and other communications hereunder shall be in writing and shall be deemed to have been duly given if delivered by hand or mailed within the continental United States by first class certified mail, return receipt requested, postage prepaid, addressed as follows:

(a) if to the Board or the Company:

Discovery Laboratories, Inc.
2600 Kelly Road, Suite 100
Warrington, PA 18976
Attn: David Lopez, Esq.

(b) if to the Executive:

W. Thomas Amick
The address on file with the records of the Company

Addresses may be changed by written notice sent to the other party at the last recorded address of that party.

13. Withholding. The Company shall be entitled to withhold from payments due hereunder any required federal, state or local withholding or other taxes.

14. Entire Agreement. This Agreement contains the entire agreement between the parties with respect to the subject matter hereof and supercedes the Employment Agreement and all other prior agreements, written or oral, with respect thereto.

15. Arbitration.

(a) If the parties are unable to resolve any dispute or claim relating directly or indirectly to this agreement (a "Dispute"), then either party may require the matter to be settled by final and binding arbitration by sending written notice of such election to the other party clearly marked "Arbitration Demand". Thereupon such Dispute shall be arbitrated in accordance with the terms and conditions of this Section 15. Notwithstanding the foregoing, either party may apply to a court of competent jurisdiction for a temporary restraining order, a preliminary injunction, or other equitable relief to preserve the status quo or prevent irreparable harm.

(b) The arbitration panel will be composed of three arbitrators, one of whom will be chosen by the Company, one by the Executive, and the third by the two so chosen. If both or either of the Company or the Executive fails to choose an arbitrator or arbitrators within 14 days after receiving notice of commencement of arbitration, or if the two arbitrators fail to choose a third arbitrator within 14 days after their appointment, the American Arbitration Association shall, upon the request of both or either of the parties to the arbitration, appoint the arbitrator or arbitrators required to complete the panel. The arbitrators shall have reasonable experience in the matter under dispute. The decision of the arbitrators shall be final and binding on the parties, and specific performance giving effect to the decision of the arbitrators may be ordered by any court of competent jurisdiction.

(c) Nothing contained herein shall operate to prevent either party from asserting counterclaim(s) in any arbitration commenced in accordance with this Agreement, and any such party need not comply with the procedural provisions of this Section 15 in order to assert such counterclaim(s).

(d) The arbitration shall be filed with the office of the American Arbitration Association ("AAA") located in New York, New York or such other AAA office as the parties may agree upon (without any obligation to so agree). The arbitration shall be conducted pursuant to the Commercial Arbitration Rules of AAA as in effect at the time of the arbitration hearing, such arbitration to be completed in a 60-day period. In addition, the following rules and procedures shall apply to the arbitration:

(i) The arbitrators shall have the sole authority to decide whether or not any Dispute between the parties is arbitrable and whether the party presenting the issues to be arbitrated has satisfied the conditions precedent to such party's right to commence arbitration as required by this Section 15.

(ii) The decision of the arbitrators, which shall be in writing and state the findings, the facts and conclusions of law upon which the decision is based, shall be final and binding upon the parties, who shall forthwith comply after receipt thereof. Judgment upon the award rendered by the arbitrator may be entered by any competent court. Each party submits itself to the jurisdiction of any such court, but only for the entry and enforcement to judgment with respect to the decision of the arbitrators hereunder.

(iii) The arbitrators shall have the power to grant all legal and equitable remedies (including, without limitation, specific performance) and award compensatory damages provided by applicable law, but shall not have the power or authority to award punitive damages. No party shall seek punitive damages in relation to any matter under, arising out of, or in connection with or relating to this Agreement in any other forum.

(iv) Except as provided in Section 11, the parties shall bear their own costs in preparing for and participating in the resolution of any Dispute pursuant to this Section 15, and the costs of the arbitrator(s) shall be equally divided between the parties.

(v) Except as provided in the last sentence of Section 15(a), the provisions of this Section 15 shall be a complete defense to any suit, action or proceeding instituted in any federal, state or local court or before any administrative tribunal with respect to any Dispute arising in connection with this Agreement. Any party commencing a lawsuit in violation of this Section 15 shall pay the costs of the other party, including, without limitation, reasonable attorney's fees and defense costs.

16. Miscellaneous.

(a) Governing Law. This Agreement shall be interpreted, construed, governed and enforced according to the laws of the State of New York without regard to the application of choice of law rules.

(b) Amendments. No amendment or modification of the terms or conditions of this Agreement shall be valid unless in writing and signed by the parties hereto.

(c) Severability. If one or more provisions of this Agreement are held to be invalid or unenforceable under applicable law, such provisions shall be construed, if possible, so as to be enforceable under applicable law, or such provisions 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.

(d) Binding Effect. This Agreement shall be binding upon and inure to the benefit of the beneficiaries, heirs and representatives of the Executive (including the Beneficiary) and the successors and assigns of the Company. The Company shall require any successor (whether direct or indirect, by purchase, merger, reorganization, consolidation, acquisition of property or stock, liquidation, or otherwise) to all or substantially all of its assets, by agreement in form and substance satisfactory to the Executive, expressly to assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform this Agreement if no such succession had taken place. Regardless whether such agreement is executed, this Agreement shall be binding upon any successor of the Company in accordance with the operation of law and such successor shall be deemed the Company for purposes of this Agreement.

(e) Successors and Assigns. Except as provided in Section16(d) in the case of the Company, or to the Beneficiary in the case of the death of the Executive, this Agreement is not assignable by any party and no payment to be made hereunder shall be subject to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance or other charge.

(f) Remedies Cumulative; No Waiver. No remedy conferred upon either party by this Agreement is intended to be exclusive of any other remedy, and each and every such remedy shall be cumulative and shall be in addition to any other remedy given hereunder or now or hereafter existing at law or in equity. No delay or omission by either party in exercising any right, remedy or power hereunder or existing at law or in equity shall be construed as a waiver thereof, and any such right, remedy or power may be exercised by such party from time to time and as often as may be deemed expedient or necessary by such party in such party's sole discretion.

(g) Survivorship. Notwithstanding anything in this Agreement to the contrary, all terms and provisions of this Agreement that by their nature extend beyond the termination of this Agreement shall survive such termination.

(h) Entire Agreement. This Agreement sets forth the entire agreement of the parties hereto with respect to the subject matter contained herein and supersedes all prior agreements, promises, covenants or arrangements, whether oral or written, with respect thereto.

(i) Counterparts. This Agreement may be executed in two or more counterparts, each of which shall constitute an original, but all of which, when taken together, shall constitute one document.

17. No Contract of Employment. Nothing contained in this Agreement will be construed as a right of the Executive to be continued in the employment of the Company, or as a limitation of the right of the Company to discharge the Executive with or without Cause.

18. Executive Acknowledgement. The Executive hereby acknowledges that he has read and understands the provisions of this Agreement, that he has been given the opportunity for his legal counsel to review this Agreement, that the provisions of this Agreement are reasonable and that he has received a copy of this Agreement.

IN WITNESS WHEREOF, the parties hereto have caused this Employment Agreement to be executed as of the date first above written.

DISCOVERY LABORATORIES, INC.

/s/ John G. Cooper
By: _____

Name: John G. Cooper
Title: President and CFO

/s/ W. Thomas Amick
_____
W. Thomas Amick

(a) **"Beneficiary"** means any individual, trust or other entity named by the Executive to receive the payments and benefits payable hereunder in the event of the death of the Executive. The Executive may designate a Beneficiary to receive such payments and benefits by completing a form provided by the Company and delivering it to the General Counsel of the Company. The Executive may change his designated Beneficiary at any time (without the consent of any prior Beneficiary) by completing and delivering to the Company a new beneficiary designation form. If a Beneficiary has not been designated by the Executive, or if no designated Beneficiary survives the Executive, then the payment and benefits provided under this Agreement, if any, will be paid to the Executive's estate, which shall be deemed to be the Executive's Beneficiary.

(b) **"Cause"** means: (i) the Executive's willful and continued neglect of the Executive's duties with the Company (other than as a result of the Executive's incapacity due to physical or mental illness), after a written demand for substantial performance is delivered to the Executive by the Company which specifically identifies the manner in which the Company believes that the Executive has neglected his duties; (ii) the final conviction of the Executive of, or an entering of a guilty plea or a plea of no contest by the Executive to, a felony; or (iii) the Executive's willful engagement in illegal conduct or gross misconduct which is materially and demonstrably injurious to the Company.

For purposes of this definition, no act or failure to act on the part of the Executive shall be considered "willful" unless it is done, or omitted to be done, by the Executive in bad faith or without a reasonable belief that the action or omission was in the best interests of the Company. Any act, or failure to act, based on authority given pursuant to a resolution duly adopted by the Board of Directors of the Company (the "Board"), or the advice of counsel to the Company, will be conclusively presumed to be done, or omitted to be done, by the Executive in good faith and in the best interests of the Company.

(c) **"Change of Control"** means the occurrence of any one of the following events:

(i) any "person" (as defined in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934 (the "Exchange Act")), other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company, an underwriter temporarily holding securities pursuant to an offering of such securities or any corporation owned, directly or indirectly, by the stockholders of the Company in substantially the same proportions as their ownership of stock of the Company, directly or indirectly acquires "beneficial ownership" (as defined in Rule 13d-3 under the Exchange Act) of securities representing 35% of the combined voting power of the Company's then outstanding securities;

(ii) persons who, as of the date of this Agreement constitute the Board (the "Incumbent Directors") cease for any reason, including without limitation, as a result of a tender offer, proxy contest, merger or similar transaction, to constitute at least a majority thereof; provided, that any person becoming a director of the Company subsequent to the date of this Agreement shall be considered an Incumbent Director if such person's election or nomination for election was approved by a vote of at least two-thirds (2/3) of the Incumbent Directors in an action taken by the Board or a Committee thereof; provided, further, that any such person whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of members of the Board or other actual or threatened solicitation of proxies or consents by or on behalf of a "person" (as defined in Section 13(d) and 14(d) of the Exchange Act) other than the Board, including by reason of agreement intended to avoid or settle any such actual or threatened contest or solicitation, shall not be considered an Incumbent Director;

(iii) the consummation of a reorganization, merger, statutory share exchange, consolidation or similar corporate transaction (each, a "Business Combination") other than a Business Combination in which all or substantially all of the individuals and entities who were the beneficial owners of the Company's voting securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 50% of the combined voting power of the voting securities of the entity resulting from such Business Combination (including, without limitation, an entity which as a result of the Business Combination owns the Company or all or substantially all of the Company's assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership of the Company's voting securities immediately prior to such Business Combination; or

(iv) the Company consummates a sale of all or substantially all of the assets of the Company or the stockholders of the Company approve a plan of complete liquidation of the Company.

(d) **"Change of Control Date"** means any date after the date hereof on which a Change of Control occurs; provided, however, that if a Change of Control occurs and if the Executive's employment with the Company is terminated or an event constituting Good Reason (as defined below) occurs prior to the Change of Control, and if it is reasonably demonstrated by the Executive that such termination or event (i) was at the request of a third party who has taken steps reasonably calculated to effect the Change of Control, or (ii) otherwise arose in connection with or in anticipation of the Change of Control then, for all purposes of this Agreement, the Change of Control Date shall mean the date immediately prior to the date of such termination or event.

(e) **"Code"** means the Internal Revenue Code of 1986, as amended and the regulations promulgated thereunder.

(f) **"Date of Termination"** means the date specified in a Notice of Termination pursuant to Section 8 hereof, or the Executive's last date as an active employee of the Company before a termination of employment due to death, Disability or other reason, as the case may be.

(g) **"Disability"** means a mental or physical condition that renders the Executive substantially incapable of performing his duties and obligations under this Agreement, after taking into account provisions for reasonable accommodation, as determined by a medical doctor (such doctor to be mutually determined in good faith by the parties) for three or more consecutive months or for a total of six months during any 12 consecutive months; provided, that during such period the Company shall give the Executive at least 30 days' written notice that it considers the time period for disability to be running.

(h) **"Effective Period"** means the period beginning on the Change of Control Date and ending 24 months after the date of the related Change of Control.

(i) **"Good Reason"** means, unless the Executive has consented in writing thereto, the occurrence of any of the following: (i) the assignment to the Executive of any duties inconsistent with the Executive's position, including any change in status, title, authority, duties or responsibilities or any other action which results in a material diminution in such status, title, authority, duties or responsibilities; (ii) a reduction in the Executive's Base Salary by the Company; (iii) the relocation of the Executive's office to a location more than 30 miles from Doylestown, Pennsylvania; (iv) the failure of the Company to comply with the provisions of Section 6(a); (v) following a Change of Control, unless a plan providing a substantially similar compensation or benefit is substituted, (A) the failure by the Company to continue in effect any material fringe benefit or compensation plan, retirement plan, life insurance plan, health and accident plan or disability plan in which the Executive was participating prior to the Change of Control, or (B) the taking of any action by the Company which would adversely affect the Executive's participation in or materially reduce his benefits under any of such plans or deprive him of any material fringe benefit; or (vi) the failure of the Company to obtain the assumption in writing of the Company's obligation to perform this Agreement by any successor to all or substantially all of the assets of the Company within 15 days after a Business Combination or a sale or other disposition of all or substantially all of the assets of the Company.

(j) **"Highest Annual Bonus"** means the largest annual cash bonus paid to the Executive by the Company with respect to the three fiscal years of the Company immediately preceding the year containing the Change of Control Date or the Date of Termination, as applicable (annualized for any fiscal year consisting of less than 12 full months).

PROPRIETARY INFORMATION AND INVENTIONS,
NON-SOLICITATION AND
NON-COMPETITION AGREEMENT

The following is an agreement ("Agreement") between Discovery Laboratories, Inc., a Delaware corporation (the "Company"), and any successor in interest, and me, W. Thomas Amick, and this Agreement is a material part of the consideration for my employment by the Company:

1. Job Title and Responsibility: I understand that my job title with the Company will be Chief Executive Officer, and that the Company may change this title at any time. My job duties and responsibilities will be those assigned to me by the Company from time to time.

2. Consideration. I understand that the consideration to me for entering into this Agreement is my employment with the Company at my base salary of $400,000.00, and I agree that this consideration is fully adequate to support this Agreement.

3. Proprietary Information. I recognize that the Company is engaged in a continuous program of research, development and production. I also recognize that the Company possesses or has rights to secret, private, confidential information and processes (including processes and information developed by me during my employment by the Company) which are valuable, special and unique assets of the Company and which have commercial value in the Company's business ("Proprietary Information"). By way of illustration, this Proprietary Information includes, but is not limited to, information and details regarding the Company's business, trade or business secrets, inventions, intellectual property, systems, policies, records, reports, manuals, documentation, models, data and data bases, products, processes, operating systems, manufacturing techniques, research and development techniques and processes, devices, methods, formulas, compositions, compounds, projects, developments, plans, research, financial data, personnel data, internal business information, strategic and staffing plans and practices, business, marketing, promotional or sales plans, practices or programs, training practices and programs, costs, rates and pricing structures and business methods, computer programs and software, customer and supplier identities, information and lists, confidential information regarding customers and suppliers, and contacts at or knowledge of Company suppliers and customers or of prospective or potential customers of the Company.

4. Obligation of Confidentiality. I understand and agree that my employment creates a relationship of confidence and trust between the Company and me with respect to (i) all Proprietary Information, and (ii) the confidential information of others with which the Company has a business relationship. At all times, both during my employment by the Company and after the termination of my employment (whether voluntary or involuntary), I will keep in confidence and trust all such information, and I will not use, reveal, communicate, or disclose any such Proprietary Information or confidential information to anyone or any entity, without the written consent of the Company, unless I am ordered to make disclosure by a court of competent jurisdiction.

5. Ownership, Disclosure and Assignment of Proprietary Information and Inventions. In addition, I hereby agree as follows:

(a) Ownership and Assignment. All Proprietary Information is, and shall be, the sole and exclusive property of the Company and its assigns, and the Company and its assigns shall be the sole and exclusive owner of all Proprietary Information, including, but not limited to, trade secrets, inventions, patents, trademarks, copyrights, and all other rights in connection with such Proprietary Information. I agree that I have no rights in such Proprietary Information. I hereby assign, and shall assign, to the Company and its assigns any and all rights, title and interest I may have or acquire in such Proprietary Information. Any copyrightable work prepared in whole or in part by me in the course of my employment shall be deemed "a work made for hire" under applicable copyright laws, and the Company and its assigns shall own all of the rights in any copyright.

(b) Return of Materials and Property. All documents, records, apparatus, equipment, data bases, data and information stored in computers or on electronic disks, and other electronic, computer, intellectual, and physical property ("Materials and Property"), whether or not pertaining to Proprietary Information, furnished to me by the Company or produced by me or others in connection with employment, shall be and remain the sole and exclusive property of the Company. I shall return to the Company all such Materials and Property as and when requested by the Company. Even if the Company does not so request, I shall return all such Materials and Property upon termination of employment by me or by the Company for any reason, and I will not take with me any such Materials or Property, or any reproduction thereof, upon such termination.

(c) Notification. During the term of my employment and for one (1) year thereafter, I will promptly disclose to the Company, or any persons designated by it, all improvements, inventions, intellectual property, works of authorship, formulas, ideas, processes, techniques, discoveries, developments, designs, innovations, know-how and data, and creative works in which copyright and/or unregistered design rights will subsist in various media (all collectively called herein, "Inventions"), whether or not such Inventions are patentable, which I make or conceive, contribute to, reduce to practice, or learn, either alone or jointly with others.

(d) Ownership of Inventions. I agree and acknowledge that all Inventions which I make, conceive, develop, or reduce to practice (in whole or in part, either alone or jointly with others) at any time during my employment by the Company, and (i) which were created using the equipment, supplies, facilities or trade secret information of the Company, or (ii) which were developed during the hours for which I was compensated by the Company, or (iii) which relate, at the time of conception, creation, development or reduction to practice, to the business of the Company or to its actual or demonstrably anticipated research and development, or (iv) which result from any work performed by me for the Company, shall be the sole and exclusive property of the Company and its assigns (and to the fullest extent permitted by law shall be deemed works made for hire), and the Company and its assigns shall be the sole and exclusive owner of all Inventions, patents, copyrights and all other rights in connection therewith. I hereby assign to the Company any and all rights I may have or acquire in such Inventions. I agree that any Invention required to be disclosed under paragraph (c), above, within one (1) year after the termination of my employment shall be presumed to have been conceived or made during my employment with the Company and will be assigned to the Company unless and until I prove and establish to the contrary.

(e) Assistance and Cooperation. With respect to Inventions described in paragraph (d), above, I will assist the Company in every proper way (but at the Company's expense) to obtain, and from time to time enforce, patents, copyrights or other rights on these Inventions in any and all countries, and will execute all documents reasonably necessary or appropriate for this purpose. This obligation shall survive the termination of my employment. In the event that the Company is unable for any reason whatsoever to secure my signature to any document reasonably necessary or appropriate for any of the foregoing purposes (including renewals, extensions, continuations, divisions or continuations in part), I hereby irrevocably designate and appoint the Company, and its duly authorized officers and agents, as my agents and attorneys-in fact to act for and in my behalf and instead of me, but only for the purpose of executing and filing any such document and doing all other lawfully permitted acts to accomplish the foregoing purposes with the same legal force and effect as if executed by me.

(f) Exempt Inventions. I understand that this Agreement does not require assignment of an Invention for which no equipment, supplies, facilities, resources, or trade secret information of the Company was used and which was developed entirely by me on my own time, unless the invention relates, (i) directly to the business of the Company, or (ii) to the Company's actual or demonstrably anticipated research or development. However, I will disclose to the Company any Inventions I claim are exempt, as required by paragraph (c), above, in order to permit the Company to determine such issues as may arise. Such disclosure shall be received in confidence by the Company.

6. Prior Inventions. As a matter of record I attach hereto as Exhibit A a complete list of all inventions or improvements relevant to the subject matter of my employment by the Company which have been made or conceived or first reduced to practice by me, alone or jointly with others, prior to my employment with the Company, that I desire to remove from the operation of this Agreement, and I covenant that such list is complete. If no such list is attached to this Agreement, I represent that I have no such inventions and improvements at the time of my signing this Agreement.

7. Other Business Activities. So that the Company may be aware of the extent of any other demands upon my time and attention, I will disclose to the Company (such disclosure to be held in confidence by the Company) the nature and scope of any other business activity in which I am or become engaged during the term of my employment. During the term of my employment, I will not engage in any business activity or employment which is in competition with, or is related to, the Company's business or its actual or demonstrably anticipated research and development, or that will affect in any manner my ability to perform fully all of my duties and responsibilities for the Company.

8. Non-Interference and Non-Solicitation of Employees, Customers and Others. I will not now or at any time in the future disrupt, damage, impair or interfere with the business of the Company, whether by way of interfering with or raiding its employees, disrupting its relationships with customers, agents, vendors, distributors or representatives, or otherwise. During my employment with the Company and for eighteen (18) months thereafter, I will not directly or indirectly induce, encourage or solicit any employee of the Company to leave the Company for any reason, unless specifically requested to take such action in writing by the Company.

9. Non-Competition During and After Employment. I agree that the time and activity restrictions in this paragraph are wholly necessary and are reasonable to protect the legitimate business interests of the Company. During my employment with the Company or at any time within a period of one (1) year after the termination of my employment (whether the termination is by me or the Company), I will not directly or indirectly, without the prior written consent of the Company, either as an employee, employer, consultant, agent, principal, partner, stockholder, corporate officer, director, or in any other individual or representative capacity, compete with the Company in the business of developing or commercializing pulmonary surfactants.

10. Obligations to Former Employers. I represent that my execution of this Agreement, my employment with the Company, and my performance of my duties and proposed duties to the Company will not violate any obligations or agreements I have, or may have, with any former employer or any other third party, including any obligations and agreements requiring me not to compete or to keep confidential any proprietary or confidential information. I have not entered into, and I will not enter into, any agreement which conflicts with this Agreement or that would, if performed by me, cause me to breach this Agreement. I further represent that I have no knowledge of any pending or threatened litigation to which the Company may become a party by virtue of my association with the Company. I further agree to immediately inform the Company of any such pending or threatened litigation should it come to my attention during the course of my employment. I also agree that I provided to the Company for its inspection before I signed this Agreement all confidentiality, non-compete, non-solicitation, and all other employment-related agreements that I am party to or which involve me.

11. Confidential Information of, and Agreements with, Former Employers. In the course of performing my duties to the Company, I will not utilize any trade secrets, proprietary or confidential information of or regarding any former employer or business affiliate, nor violate any written or oral, express or implied agreement with any former employer or business affiliate.

12. United States Government Obligations. I acknowledge that the Company from time to time may have agreements with other persons or with the United States Government, or agencies thereof, which impose obligations or restrictions on the Company regarding inventions made during the course of work under such agreements or regarding the confidential nature of such work. I agree to be bound by all such obligations and restrictions which are made known to me and to take all action necessary to discharge the obligations of the Company under such agreements.

13. Remedies. I acknowledge that my failure to comply with, or my breach of, any of the terms and conditions of this Agreement shall irreparably harm the Company, and that money damages would not adequately compensate the Company for this harm. Accordingly, I acknowledge that in the event of a threatened or actual breach by me of any provision of this Agreement, in addition to any other remedies the Company may have at law, the Company shall be entitled to equitable relief in the form of specific performance, temporary restraining order, temporary or permanent injunction or any other equitable remedy then available, without requiring the Company to post any bond. I agree that nothing herein contained shall be construed as prohibiting the Company from pursuing any other remedies available to it for such threatened or actual breach, including money damages, and I agree that the Company shall be entitled to recover from me any attorney's fees it incurs in enforcing the terms of this Agreement.

14. Not an Employment Agreement. I acknowledge and agree that this Agreement is not a contract of employment, that it should not be construed as a guarantee of my employment for any period of time, and that I am employed by the Company at will and my employment may be terminated by the Company for any lawful reason or no reason.

15. Miscellaneous.

(a) Reformation and Severability. If any provision of this Agreement is held to be invalid or unenforceable under applicable law, such provision shall be reformed and/or construed, if possible, to be enforceable under applicable law; otherwise, such provision shall be excluded from this Agreement and the balance of the Agreement shall remain fully enforceable and valid in accordance with its terms.

(b) No Waiver. No delay or omission by the Company in exercising any right hereunder will operate as a waiver of that or any other right. A waiver or consent given by the Company on any one occasion is effective only in that instance and will not be construed as a bar to or waiver of any right on any other occasion.

(c) Reassignment. I expressly consent to be bound by the provisions of this Agreement for the benefit of the Company or any subsidiary or affiliate thereof to whose employment I may be transferred, without the necessity that this Agreement be reassigned at the time of such transfer.

(d) Applicable Law. This Agreement shall be governed by and construed in accordance with the laws of the Commonwealth of Pennsylvania (but not the law or principles of conflict of laws), and the parties submit to the jurisdiction of the courts of Pennsylvania.

(e) Effective Date. This Agreement shall be effective as of the first day of my employment by the Company, shall be binding upon me, my heirs, executors, assigns and administrators, and shall inure to the benefit of the Company, its successors and assigns.

(f) Entire Agreement. This Agreement contains the entire agreement of the parties relating to the subject matter herein, and may not be waived, changed, extended or discharged except by an agreement in writing signed by both parties.

(g) ACKNOWLEDGEMENT. I acknowledge and agree that I have fully read and that I understand all of the terms and provisions of this Agreement, that I have had the opportunity to consult with an attorney and to discuss this Agreement with an attorney, that I have had any questions regarding the effect of this Agreement or the meaning of its terms answered to my satisfaction, and, intending to be legally bound hereby, I freely and voluntarily sign this Agreement.

Accepted and Agreed to:

W. THOMAS AMICK	DISCOVERY LABORATORIES, INC.
/s/ W. Thomas Amick	/s/ Kathryn Cole
(Name)	Kathryn Cole
10/18/10	Senior Vice President, Human Resources
(Date)	
(SS#)	

EXHIBIT A

Discovery Laboratories, Inc.
2600 Kelly Road, Suite 100
Warrington, PA 18976

Attn:

1. The following is a complete list of all inventions or improvements relevant to the subject matter of my employment by Discovery Laboratories, Inc. (the "Company") that have been made or conceived or first reduced to practice by me, alone or jointly with others, prior to my employment by the Company that I desire to remove from the operation of the Company's Proprietary Information and Inventions, Non-Solicitation and Non-Competition Agreement.

_____ No inventions or improvements.

_____ See below: Any and all inventions regarding

_____ Additional sheets attached.

2.I propose to bring to my employment the following materials and documents of a former employer:

_____ No materials or documents.

_____ See below:

_____
W. Thomas Amick

_____
Date

Exhibit 31.1

CERTIFICATIONS

I, W. Thomas Amick, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Discovery Laboratories, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 15, 2010

/s/ W. Thomas Amick

W. Thomas Amick
Chairman of the Board and Chief Executive Officer

Exhibit 31.2

CERTIFICATIONS

I, John G. Cooper, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Discovery Laboratories, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 15, 2010

/s/ John G. Cooper

John G. Cooper
President and Chief Financial Officer

Exhibit 32.1

CERTIFICATIONS

Pursuant to 18 U.S.C. § 1350, each of the undersigned officers of Discovery Laboratories, Inc. (the "Company") hereby certifies that, to his knowledge, the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2010 (the "Report") fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and that the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 15, 2010

/s/ W. Thomas Amick

W. Thomas Amick
Chairman of the Board and Chief Executive Officer

/s/ John G. Cooper

John G. Cooper
President and Chief Financial Officer

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to us and will be retained by us and furnished to the SEC or its staff upon request.

This certification is being furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that section. This certification will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.