QUESTAR CORP
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

(Amendment No. __)

Filed by the Registrant x Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement

¨ **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

x Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to §240.14a-12

Questar Corporation

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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x No fee required.

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(1) Amount Previously Paid:

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(3) Filing Party:

(4) Date Filed:

QUESTAR CORPORATION

180 East 100 South

P. O. Box 45433

Salt Lake City, Utah 84145-0433

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

To Be Held on May 20, 2008

The Annual Meeting of Shareholders of Questar Corporation, a Utah corporation (Questar or the Company), will be held at the Westin Tabor Center Hotel, 1672 Lawrence Street, Denver, Colorado, on Tuesday, May 20, 2008, at 8:00 a.m. local time. The purpose of the meeting is to:

1. Elect three directors to serve three-year terms and one director to serve a one-year term;

2. Ratify the selection of Ernst & Young LLP as the Company s auditor;

3. Vote on a shareholder proposal regarding declassifying the Board of Directors; and

4. Act on any other matters that may properly come before the meeting.

Only holders of common stock at the close of business on March 24, 2008, the record date of the Annual Meeting, may vote at the Annual Meeting or any adjournment of it. You may revoke your proxy at any time before it is voted. If you have shares registered in the name of a brokerage firm or trustee and plan to attend the meeting, please obtain a letter, account statement, or other evidence of your beneficial ownership of shares to facilitate your admittance to the meeting. This proxy statement is being provided to shareholders on or about April 9, 2008.

By Order of the
Board of Directors

Abigail L. Jones
Corporate Secretary
Salt Lake City, Utah
April 9, 2008

YOUR VOTE IS IMPORTANT

Whether or not you plan to attend the Annual Meeting, please vote as soon as possible. You may vote over the Internet, as well as by telephone or by mailing a proxy card. Voting via the Internet, by phone or by written proxy will ensure your representation at the Annual Meeting if you

do not attend in person. Please review the instructions you received regarding each of these voting options. Voting over the Internet or by telephone is fast and convenient, and your vote is immediately tabulated. By using the Internet or telephone, you help reduce the cost of postage and proxy tabulations.

QUESTAR CORPORATION PROXY STATEMENT

The Board of Directors of Questar Corporation is soliciting proxies from its shareholders to be used at the Annual Meeting on Tuesday, May 20, 2008. This proxy statement contains information related to the Annual Meeting. At the Annual Meeting, holders of common stock will elect three directors of the Company for three-year terms that expire in May 2011 and one director for a one-year term that expires in May 2009. Shareholders will also vote on whether to ratify Ernst & Young LLP as the Company s auditor and on a shareholder proposal requesting that the Company declassify its Board of Directors. Information concerning the Annual Meeting, and solicitation of proxies for it, is presented in a question-and-answer format.

Q: What is the Notice of Internet Availability of Proxy Materials that I received in the mail this year instead of a full set of proxy materials?

A: In accordance with rules recently adopted by the Securities and Exchange Commission (SEC), we may now furnish proxy materials, including this proxy statement and our 2007 Annual Report to Shareholders, by providing access to these documents on the Internet instead of mailing a printed copy of our proxy materials to our shareholders. Based on these changes, most of our shareholders have already received a Notice of Internet Availability of Proxy Materials (the Notice), which provides instructions for accessing our proxy materials on a Web site referred to in the Notice or for requesting to receive printed copies of the proxy materials by mail.

If you would like to receive a paper copy of the proxy materials for our 2008 Annual Meeting or for all future meetings, you should follow the instructions for requesting such materials included in the Notice. The delivery options that we have chosen this year will provide our shareholders with the proxy materials, while lowering the cost of the delivery and reducing the environmental impact of printing.

Q: What am I voting on?

A: You can cast your votes to elect four nominees for director positions. The nominees for new three-year terms are three incumbent directors: Phillips S. Baker, Jr., L. Richard Flury, and Bruce A. Williamson. The nominee for a one-year term is incumbent director James A. Harmon. You are also being asked to ratify Ernst & Young LLP as the Company s auditor and to vote on a shareholder proposal requesting that the Company declassify its Board of Directors.

Q: Who can vote?

A: Shareholders who owned shares as of the close of business on March 24, 2008, may vote at the Annual Meeting. Each holder is entitled to one vote for each share held on such date.

Q: If I am a shareholder of record, how do I vote?

A. *You may vote via the Internet.* You may vote by proxy over the Internet by following the instructions provided in the Notice.

You may vote via the telephone. You may submit your vote by proxy over the telephone by following the instructions provided with the proxy materials.

You may vote by mail. If you received a printed set of the proxy materials, you may submit your vote by completing and returning the separate proxy card in the prepaid and addressed envelope.

You may vote in person at the meeting. All shareholders of record may vote in person at the Annual Meeting. Written ballots will be passed out to anyone who wants to vote at the meeting.

Q: If my shares are held by a broker, bank or other nominee, how do I vote?

A: If your shares are held in street name by a broker, bank or other nominee, please refer to the instructions provided by that broker, bank or nominee regarding how to vote or how to revoke your voting instructions.

Q: How will my shares held in street name be voted if I do not provide voting instructions?

A: New York Stock Exchange (NYSE) rules determine whether proposals presented at shareholder meetings are routine or not. If a proposal is routine, a broker or other entity holding shares for an owner in street name may vote on the proposal without receiving voting instructions from the owner. If a proposal is not routine, the broker or other entity may vote on the proposal only if the owner has provided voting instructions. A

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

Pursuant to NYSE rules, if you are the street-name holder and you do not provide instructions to your broker on Items No. 1 (Election of Directors) or 2 (Ratification of Auditors) below, your broker can vote your shares at its discretion on these matters. If you are a street-name holder and do not provide instructions to your broker on Item No. 3 (Shareholder Proposal), your broker may not vote your shares on this matter.

Q: Who is soliciting my proxy?

A: Questar s Board of Directors.

Q: Who is paying for the solicitation?

A: The Company is paying for the solicitation of proxies and will reimburse banks, brokers, and other custodians for reasonable charges to forward materials to beneficial holders.

Q: What constitutes a quorum?

A: On March 24, 2008, the Company had 173,185,539 shares of common stock issued and outstanding. A majority of the shares, or 86,592,770 shares, constitutes a quorum. Abstentions, withheld votes and broker non-votes are counted for determining whether a quorum is present.

Q: What vote is required to approve each proposal?

A: *Election of Directors:* Election of the director nominees named in Item No. 1 requires the affirmative vote of a plurality of the shares of our common stock present in person or represented by proxy at the Annual Meeting and entitled to vote. The candidates receiving the highest number of affirmative votes of the shares entitled to be voted will be elected as directors. Shares represented by executed proxies will be voted, if authority to do so is not withheld, for the election of the nominees named in Item No. 1. Votes may be cast in favor of or withheld with respect to all of the director nominees, or any of them. Abstentions and broker non-votes, if any, will not be counted as having been voted and will have no effect on the outcome of the vote on the election of directors. Shareholders may not cumulate votes in the election of directors.

A: *Ratification of the Company s Auditor:* Ratification of the selection of Ernst & Young LLP as our independent accountants for fiscal year 2008, as specified in Item No. 2, requires that more shares are voted in favor of the proposal than against the proposal. If this selection is not ratified by our shareholders, the Finance & Audit committee may reconsider its recommendation. Abstentions and broker non-votes, if any, will not be considered votes cast and will have no effect on the outcome of this proposal.

A: *Shareholder Proposal Relating to the Declassification of the Board of Directors:* Approval of the shareholder proposal on Board declassification, as specified in Item No. 3, requires that more shares are voted in favor of the proposal than against the proposal. Abstentions and broker non-votes, if any, will not be considered votes cast and will have no effect on the outcome of this proposal.

Q: Who may attend the Annual Meeting?

A: Any shareholder of record as of March 24, 2008, may attend. If you own shares through a nominee or trustee, please obtain a letter, account statement, or other evidence of your ownership of shares as of such date.

Q: How will my vote be handled on other matters?

A: Questar s Bylaws limit the matters presented at an Annual Meeting to those in the notice, those properly presented by the Board of Directors, and those presented by shareholders so long as the shareholder gives the corporate secretary written notice of the matter at least 90 days but not more than 120 days prior to the anniversary date of the prior year s Annual Meeting. We do not expect any other matter to come before the meeting. If any other matter is presented at the Annual Meeting, your signed proxy gives the named proxies authority to vote your shares at their discretion. (See Other Matters below for a detailed discussion of the Company s Bylaw requirements.)

Q: How do I revoke a proxy?

A: You may revoke your proxy by submitting a new proxy with a later date, including a proxy given via the Internet or telephone, or by notifying the corporate secretary before the meeting by mail at the address shown on the Notice of Annual Meeting. If you attend the Annual Meeting in person and vote by ballot, any previously submitted proxy will be revoked.

Q: When are shareholder proposals due for the next Annual Meeting?

A: To be considered for presentation at the Company s 2009 Annual Meeting and included in the proxy statement pursuant to Rule 14a-8 (17 CFR 240.14a-8), a shareholder proposal must be received at the Company s office no later than December 11, 2008.

ITEM NO. 1 ELECTION OF DIRECTORS

The Company s Restated Articles of Incorporation provide for a Board of 13 directors, divided into three classes approximately equal in number, elected to serve three-year terms.

The terms of four directors, Phillips S. Baker, Jr., L. Richard Flury, James A. Harmon and Bruce A. Williamson, expire at this Annual Meeting. Messrs. Baker, Flury and Williamson have been nominated for three-year terms. Mr. Harmon, who has reached retirement age, has been nominated for a one-year term. The Board decided to waive the retirement policy to allow Mr. Harmon to serve for one year due to his continuing active involvement in business, financial and community affairs and his many contributions to the Board of Directors. This nomination will move Mr. Harmon into the group of directors with terms expiring in 2009, making the classes of directors more equal in size, consistent with the Company s Bylaws. Unless you give other instructions for your shares, the proxies will be voted for the nominees.

All of the nominees have advised the Company that they are willing to serve as directors. However, in the event that any nominee is unwilling or unable to serve as a director, those named in the proxy may vote, at their discretion, for any other person.

Biographical information concerning the nominees, and the current directors of the Company whose terms will continue after the Annual Meeting, appears below. Unless otherwise indicated, the nominees have been engaged in the same principal occupation for the past five years. Ages are correct as of the date of the proxy statement.

NOMINEES (TERMS EXPIRING IN 2011)

Mr. Phillips S. Baker, Jr., age 48, is the president, chief executive officer and a director of Hecla Mining Company. Mr. Baker served as chief financial officer of Hecla from May 2001 to June 2003, and as chief operating officer from November 2001 to May 2003, before being named as chief executive officer in May 2003.
He was appointed to serve as a director of Questar effective February 10, 2004.

Mr. L. Richard Flury, age 60, retired as chief executive, Gas and Power for BP plc on December 31, 2001. He had served in that position from January 1999 to his retirement. Prior to working for BP plc and BP Amoco plc, Mr. Flury held a number of key management positions with Amoco Corp., including chief executive for worldwide exploration and
production. He was first elected to Questar s Board in May 2002. Mr. Flury also serves as a director of Chicago Bridge and Iron Company, N.V., and Callon Petroleum Company.

Mr. Bruce A. Williamson, age 48, is the chairman, chief executive officer and president of Dynegy Inc. Mr. Williamson was named Dynegy s president and chief executive officer, elected to that company s board of directors in October 2002 and elected chairman by the board of directors in May 2004. Mr. Williamson joined Questar's board of directors in 2006.

NOMINEE (TERM EXPIRING IN 2009)

Mr. James A. Harmon, age 72, was reap- pointed to serve as a Questar director in June of 2001 after serving as chairman and president of the Export-Import Bank of the United States. He previously served as a director of the Company from 1976 to 1997. He currently is chairman of a financial advisory firm, Harmon & Co. LLC, and is also chairman of the Caravel
Fund (International) Ltd., an emerging-markets fund. Mr. Harmon is also the chairman of the World Resources Institute, a global policy and research institution and a senior advisor to the Rothschild Group. He is a member of the Board of Directors of the School of International and Public Affairs at Columbia University, Africare and the Center for Global Development.

CONTINUING DIRECTORS (PRESENT TERM EXPIRES IN 2009)

Mr. Keith O. Rattie, age 54, serves as the Company s chairman, president and chief executive officer. He was named president effective February 1, 2001, chief executive officer May 1, 2002, and chairman May 20, 2003. He also serves as a director of Zions First National Bank. He is the past chairman of the Board of the Interstate Natural Gas Association of America.

Mr. M. W. Scoggins, age 60, has served as president of the Colorado School of Mines since June 2006. He retired as executive vice president of ExxonMobil Production Company in April 2004. He held that position from December 1999 until his retirement. He was first appointed to the Questar Board in February 2005. He also serves as a director of Trico Marine Services, Inc. and Venoco, Inc., and is a member of the National Advisory Council of the United States Department of Energy s National Renewable Energy Laboratory.

Mr. Harris H. Simmons, 53, is chairman, president and chief executive officer of Zions Bancorporation and chairman of

the Board of Zions First National Bank. Mr. Simmons has served as a director of the Company since 1992. He also serves as a director of O. C. Tanner Company and National Life Holding Company.

CONTINUING DIRECTORS (PRESENT TERM EXPIRES IN 2010)

Ms. Teresa Beck, age 53, has served as a director of the Company since 1999. She was president of American Stores from 1998 to 1999, and was American Stores chief financial officer from 1993 to 1998. She is a director of Lexmark International, Inc. and Amylin Pharmaceuticals, Inc. and a trustee of Intermountain Healthcare, the Nature
Conservancy and the Nature Conservancy of Utah. She serves on the University of Utah National Advisory Council and the advisory board for the David Eccles School of Business at the University of Utah.

Mr. R. D. Cash, age 65, served as the Company s chief executive officer from May 1984 to May 2002 and as the Company s chairman of the board from May 1985 to May 2003. Mr. Cash has been a director of the Company since 1977 and also serves as a director of Zions Bancorporation, National Fuel Gas Company, Associated Electric and Gas
Insurance Services Limited, and Texas Tech Foundation, Inc.

Mr. Robert E. McKee, III, age 61, was appointed to serve as a director of the Company effective April 1, 2003. He served as a senior oil advisor to the Coalition Provisional Authority and the Iraqi Oil Ministry in Iraq to assist with the rebuilding of its oil industry from September 1, 2003, to March 18, 2004.
He retired on March 31, 2003, after 37 years with ConocoPhillips and Conoco, Inc., including 10 years as executive vice president, Exploration and Production (1992-2002). He is a director of Parker Drilling Company and the Post Oak Bank, and a member of the President s Council for the Colorado School of Mines. He is currently serving as chairman of Enventure Global Technology (an expandable tubular technology company).

Mr. Gary G. Michael, age 67, has been a director of the Company since 1994. He served as chairman and chief executive officer of Albertsons, Inc. from February 1991 to April 2001. He served as interim president of the University of Idaho from June 2003 until August 2004. He is a director of Office Max, Inc., Idacorp Inc. and The Clorox Company.

Mr. Charles B. Stanley, age 49, serves as executive vice president and chief operating officer of the Company. He has served as a director of the Company since November 1, 2002. Mr. Stanley has responsibility for the Company s Market Resources business segment, and is the president and chief executive officer of each entity within that group, *i.e.*,
Questar Market Resources, Inc., Wexpro Company (exploration and production, cost-of-service properties), Questar Exploration and Production Company (oil and gas exploration and production), Questar Gas Management Company (gas gathering and processing) and Questar Energy Trading Company (wholesale marketing and gas storage). He is a director of Hecla Mining Company; current president and director of the Independent Petroleum Association of Mountain States (IP-AMS); and a board member of the American Exploration and Production Council (AXPC). He is a trustee of the American Geologic Institute Foundation and board member of the Utah Wildlife and Conservation Foundation.

GOVERNANCE INFORMATION

BOARD COMMITTEES

The Board has standing audit (Finance and Audit), nominating (Governance/Nominating), and compensation (Management Performance) committees that are each comprised solely of independent directors. Each committee has a charter. The charters, along with the Company s Business Ethics Policy and Corporate Governance Guidelines, are available on the Company s Web site (www.questar.com) and in print at the request of any shareholder. The following section contains information about Board Committees.

The table below sets forth members and chairs of the committees.

Name of Director	Finance/Audit	Management Performance	Governance/ Nominating	Executive
P. S. Baker Jr.	X		X	
T. Beck	X[1]		X	X
R. D. Cash				
L. Richard Flury		X[1]	X	X
J. A. Harmon	X	X	X[1]	X
R. E. McKee III	X	X	X	
G. G. Michael		X		X[1]
K. O. Rattie				X
M. W. Scoggins	X	X		
H. H. Simmons	X		X	X
C. B. Stanley				
B. A. Williamson	X		X	
Meetings held in 2007	8	6	3	0

[1]Chair

THE FINANCE AND AUDIT COMMITTEE

The Finance and Audit Committee reviews auditing, accounting, financial reporting, and internal control functions; appoints the Company s outside auditors; monitors financing requirements, dividend policy, and investor-relations activities; and oversees compliance activities. The Company s common stock is listed on the NYSE and is governed by its listing standards. The Committee has adopted a charter, referred to as a Statement of Responsibilities, that is available on the Company s Web site at www. questar.com and in print at a shareholder s request. The Company s Board has determined that all members of the Committee meet the independence standards of Section 303.01(B)(2)(a) and (3) of the Rules of the NYSE.

MANAGEMENT PERFORMANCE COMMITTEE

The Management Performance Committee functions as the Company s compensation committee. The Committee oversees the Company s executive-compensation program and benefit plans and policies; administers the Long-term Stock Incentive Plan, the Long-term Cash Incentive Plan, the Annual Management Incentive Plan and the Annual Management Incentive Plan II; oversees succession planning; and annually reviews the performance of and approves all compensation decisions for officers, with a particular focus on the compensation decisions involving the chief executive officer and other officers listed in the Summary Compensation Table. The Committee submits its compensation

decisions for named executive officers to the full Board for ratification. It frequently meets in executive sessions to discuss and determine compensation for officers. The Committee s Statement of Responsibilities is available on the Company s Web site at www.questar.com and in print at a shareholder s request.

The Committee, chaired by Mr. Flury, met six times in 2007. Prior to and during its February meeting, the Committee undertook a comprehensive review of executive performance and compensation to ascertain whether compensation for the Company s officers remains consistent with the objectives and practices described in more detail in the Compensation Discussion and Analysis.

The Committee periodically retains an outside consultant to perform an in-depth analysis of the total compensation paid to each of the Company s officers. In 2006, the Committee decided to retain Hewitt Consulting (Hewitt) as its executive compensation consultant for 2007 compensation. Hewitt reports directly to the Committee and the Committee retains sole authority to retain or dismiss advisors.

In October 2006, the Hewitt representative met with the Committee and presented a report that included market data, initial observations about the Company s compensation design, and qualitative analysis of that design. An executive session followed this presentation. In January 2007, the Hewitt representative met with the Committee to make recommendations about changes to the compensation program. The Committee subsequently met in executive session to discuss the Hewitt recommendations. In February 2007, the representative met with the Committee again, both in regular and executive session, and discussed recommendations about total compensation for all officers. The Committee reviewed the recommendations and determined the final salaries and incentive compensation for each officer. In determining compensation for Mr. Rattie, the Committee reviewed market data provided by Hewitt and discussed, in executive session, Mr. Rattie s performance, the Company s performance and other relevant factors.

The Committee has delegated to its Chair, Mr. Flury, authority to ratify grants of restricted stock for the purpose of retaining key employees, particularly in highly-competitive professional disciplines. The full Committee then reviews them at its next meeting. The Committee also authorized Mr. Rattie to grant restricted stock to new hires up to 25,000 total shares per year and up to 4,000 shares per grant. The delegated authority does not apply to newly hired executive officers. The full Committee then reviews the grants at its next meeting.

GOVERNANCE/NOMINATING COMMITTEE

The Governance/Nominating Committee, which functions as the Company s nominating committee, is responsible for governance activities, particularly Board and Committee evaluations and committee assignments. All members are independent directors. The Committee is currently chaired by Mr. Harmon, a long-term member of the Board. The Committee s Statement of Responsibilities is available on the Company s Web site at www.questar.com and in print at a shareholder s request. The Statement of Responsibilities defines the criteria for director nominees, including nominees recommended by shareholders and self-nominees. These criteria provide a framework for evaluating all nominees as well as incumbent directors. The key criteria are: experience as a senior officer, *(e.g.,* chief executive officer, president, chief financial officer, of a public company, or extensive experience in finance or accounting); activity in business at least part-time with skills and experience necessary to serve as chair of a board committee; willingness to commit time and energy to service as a director; experience in the Company s lines of business or understanding of the Company s business environment; ability to exercise independent judgment and make analytical inquiries; reputation for integrity and good judgment; and geographical location (residence or business activity) in states where the Company has significant operations.

The Committee will consider shareholder nominations using the criteria listed above. Shareholders interested in submitting the names of candidates who satisfy most, if not all, of the criteria listed above should submit in writing the names and qualifications of the candidate(s) to the Chair of the Governance/Nominating Committee at the Company s address. Nomination letters addressed to the Chair of the Governance/Nominating Committee, at the Company s address, will be forwarded without screening.

EXECUTIVE COMMITTEE

The Executive Committee acts on behalf of the Board of Directors and handles special assignments. The Committee s Statement of Responsibilities is available on the Company s Web site at www.questar.com and in print at a shareholder s request. The Chairman of the Committee (currently Mr. Michael) must be an independent director and functions as the Company s lead director, presiding over the executive sessions of the non-management directors who meet in regularly-scheduled executive sessions without management. The lead director is selected by the Governance/Nominating Committee, which has established the following criteria to Board members for the lead director:

1. Independence as defined by the New York Stock Exchange;

2. Experience on the Company s Board of Directors;

3. Experience as Chair of the Board s other committees;

4. Willingness to commit time and energy to service as lead director;

5. Experience in the Company s lines of business or understanding of the Company s business environment;

6. Ability to exercise independent judgment and make analytical inquiries; and

7. Integrity and leadership skills.

INDEPENDENCE OF DIRECTORS

With the exception of Messrs. Rattie and Stanley, all of the Company s directors are independent as defined by the NYSE. The criteria applied by the Company in ascertaining independence are available on its Web site at www.questar.com and in print upon request of a shareholder. The Company takes the view that a director who has a relationship with a company or other entity that purchases gas from Questar Gas Company at regulated rates can still be considered independent. In determining which directors are independent, the Board considered Mr. Cash s service as president and chief executive officer of the Company until May 2002 and as chairman of the board until May 2003. Additionally, the Board considered that during 2007, the Company and its educational foundation contributed $43,100 to the Colorado School of Mines, of which Mr. Scoggins is president, for scholarships and for the Department of Geology.

COMMUNICATIONS WITH DIRECTORS

Interested parties may communicate with the Board of Directors, including Mr. Gary G. Michael (the lead director) or all non-management directors, by sending a letter in care of the corporate secretary at Questar Corporation, 180 East 100 South, P.O. Box 45433, Salt Lake City, Utah 84145-0433. The corporate secretary has the authority to discard any solicitations, advertisements, or other inappropriate communications, but will forward any other mail to the named director or group of directors. Any mail that is directed to the full Board will be forwarded to Mr. Rattie as chairman of the board.

ATTENDANCE AT MEETINGS

The Company s Board of Directors held four regular meetings during 2007; Board Committees held a total of 17 meetings. All directors except Mr. Harmon attended at least 75 percent of the meetings. The Company s directors had an overall attendance percentage of 93 percent. The Company s directors are expected to attend the Company s Annual Meetings. All of the directors attended the Company s 2007 Annual Meeting.

DIRECTOR RETIREMENT POLICY

In May of 1992, the Board of Directors adopted a retirement policy that permits an outside director to continue serving in such position until the Annual Meeting following his 72nd birthday if still actively engaged in business, financial, and community affairs. The Company does not have a policy limiting the number of terms that any individual director may serve. For the 2008 election, the Board has waived this policy for a one-year period to allow Mr. Harmon to run for a one-year term ending in 2009. In making this decision, the Board considered Mr. Harmon s continuing active involvement in business, financial and community affairs as well as his many contributions to the Board.

MANAGEMENT PERFORMANCE COMMITTEE INTERLOCKS AND INSIDER PARTICIPATION

The members of the Management Performance Committee during the 2007 fiscal year were Mr. Flury, Mr. Harmon, Mr. McKee, Mr. Michael and Mr. Scoggins. No member of this Committee was at any time during the 2007 fiscal year or at any other time an officer or employee of the Company. Additionally, no member of this Committee had any relationship with the Company requiring disclosure under Item 404 of Regulation S-K. No executive officer of the Company has served on the compensation committee of any other entity that has or has had one or more executive officers who served as a member of the Management Performance Committee during the 2007 fiscal year

CERTAIN RELATIONSHIPS AND RELATED-PERSON TRANSACTIONS

There are no relationships or related-person transactions between the Company and any of its directors or officers that are required to be disclosed pursuant to federal securities laws. The Company requires all executive officers and directors to report to the vice president, compliance, any event or anticipated event that might qualify as a related-person transaction pursuant to Section 404(b) of Regulation S-K. The vice president, compliance then reports those transactions to the Board. The Company also collects information from questionnaires sent to officers and directors early each year that would reveal related-person transactions. If a report or questionnaire shows a potential related-person transaction, it will be investigated in accordance with the Company s Business Ethics and Compliance Policy. The Company s Finance and Audit Committee will review pending and ongoing transactions to determine whether they conflict with the best interests of the Company, impact a director s independence or conflict with the Company s Business Ethics and Compliance Policy. If a related-person transaction is completed, the Committee will determine whether rescission of the transaction, disciplinary action or reevaluation of a director s independence is required.

SECURITY OWNERSHIP, DIRECTORS AND EXECUTIVE OFFICERS

The following table lists the shares of stock beneficially owned by each of the directors, each nominee, and each named executive officer and all directors and executive officers as a group as of February 29, 2008 (unless otherwise indicated). Except as noted, each person has sole voting and investment power over the shares shown in the table.

Amount and Nature of Common Stock Beneficially Owned:

	Number of Shares Owned	Right to Acquire[1]	Percent of Class[2]	Phantom Stock Units[3]
Alan K. Allred[4,5,6]	98,745	188,568	0.16%	4,164
Phillips S. Baker, Jr.[5]	9,597	0	*	0
Teresa Beck[5]	4,046	52,400	*	28,265
R. Allan Bradley[4,5]	32,561	75,000	*	6,822
R. D. Cash[5,6]	798,171	484,790	0.74%	6,035
L. Richard Flury	4,000	14,000	*	18,053
James A. Harmon[5,6]	128,303	26,800	*	12,241
Robert E. McKee, III[5,7]	5,933	14,000	*	12,429
Gary G. Michael	26,000	0	*	50,738
S. E. Parks[4,5,6]	241,622	422,200	0.38%	11,829
Keith O. Rattie[4,5,6,8]	230,697	880,000	0.64%	33,953
M. W. Scoggins	7,700	0	*	11,756
Harris H. Simmons	108,800	87,600	0.11%	58,056
Charles B. Stanley[4,5,6]	99,493	434,000	0.31%	16,643
Bruce A. Williamson	4,000	0	*	6,872
All directors and executive officers (17 individuals including those listed above)	1,910,187	2,732,156	2.68%	280,225

[1]Indicates shares that can be acquired by exercising stock options within 60 days of February 29, 2008.

[2]Unless otherwise listed, the percentage of shares owned is less than .10%. (The percentages do not include phantom stock units.) The percentages of beneficial ownership have been calculated in accordance with Rule 13d-3(d)(1) under the Securities Exchange Act of 1934.

[3]Phantom stock units are held through the various deferred compensation plans available to the Company s directors and officers. Although these plans only permit such units to be paid in the form of cash, investment in such units represent the same investment in the performance of the Company s common stock as investment in actual shares of common stock.

[4]The Company s executive officers have shares held for their accounts in the 401(k) Plan. The number of shares opposite each of their names includes equivalent shares of stock through such Plan as of February 29, 2008, as follows: Mr. Rattie, 2,453 shares; Mr. Stanley, 7,663 shares; Mr. Parks, 48,236 shares; Mr. Allred, 44,932 shares; and Mr. Bradley, 14 shares.

[5]The number of shares includes shares of unvested restricted stock as of February 29, 2008 as follows: Mr. Rattie, 90,666 shares; Mr. Stanley, 78,000 shares; Mr. Allred, 17,132 shares; Mr. Parks, 20,998 shares; Mr. Bradley, 22,832 shares; Mr. Baker, 5,388 shares; Mr. Cash: 5,388 shares; Ms. Beck, 866 shares; Mr. Harmon, 4,722 shares and Mr. McKee, 866 shares. They receive dividends and have voting powers for the shares but cannot dispose of them until they vest.

[6]Of the total shares reported for Mr. Cash, 123,966 shares are owned by his family s private foundation. Mr. Harmon also has 4,000 shares which are owned by his family s private foundation for which he has voting and investment power. Mr. Allred owns his record shares with his spouse. Some of Messrs. Rattie s and Parks record shares are owned jointly with their spouses. All of the vested shares listed for Mr. Stanley are held in the CJ Trust of which he and his wife are trustees.

[7]Two hundred shares of common stock are held in the name of the McKee Family Trust.

[8]Mr. Rattie is the chairman of the Board of Trustees of the Questar Corporation Educational Foundation, the Questar Corporation Arts Foundation, and the Questar Corporation Native American Scholarship Foundation, three nonprofit corporations that own an aggregate of 141,608 shares of the Company s common stock as of February 29, 2008. As chairman, Mr. Rattie has voting power for such shares, but disclaims any beneficial ownership of the shares. The shares are not included in the total opposite his name.

SECURITY OWNERSHIP PRINCIPAL HOLDERS

The Company knows of no person or entity that beneficially owns at least five percent of its common stock.

EQUITY COMPENSATION PLAN INFORMATION

The following information is accurate as of December 31, 2007:

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)
Equity compensation plans approved by security holders	4,628,601	$15.42	10,222,228
Equity compensation plans not approved by security holders	0	0	0
Total	**4,628,601**	**$15.42**	**10,222,228**

EXECUTIVE COMPENSATION

COMPENSATION DISCUSSION AND ANALYSIS

OBJECTIVES

The Company s executive compensation program is designed to:

Attract, motivate, and retain the management talent required to achieve Company objectives;

Focus management efforts on both short-term and long-term drivers of shareholder value;

Tie a significant portion of executive compensation to Company long-term stock-price performance and thus shareholder returns; and

Foster a results-oriented culture while enhancing the Company s reputation for ethics and integrity.

COMPONENTS

Compensation for named executive officers is comprised of the following components:

- Base salary;
- Annual Management Incentive Plan (AMIP) or Annual Management Incentive Plan II (AMIP II);
- Long-term Cash Incentive Plan (LTCIP);
- Restricted stock and/or stock option grants under the Long-term Stock Incentive Plan (LTSIP); and
- Employee benefits, including retirement, health and welfare benefits.

COMPENSATION PHILOSOPHY & ROLE OF MANAGEMENT PERFORMANCE COMMITTEE

To attract, motivate and retain the executive talent required to achieve corporate objectives, the Company believes it must offer its key executives a competitive compensation package comprised of both short-term and long-term components. The short-term component includes annual base salary plus an annual cash-bonus opportunity (AMIP or AMIP II) that is at risk and tied to specific pre-defined performance targets. The long-term component consists of the LTCIP, a cash plan that ties bonus opportunity to the Company s total shareholder return over a three-year period compared to an industry peer group selected by the Committee at the start of the period, and LTSIP, a stock incentive plan that encourages retention through meaningful forfeitable stock and option grants and aligns compensation with shareholder interests. To ensure that executive compensation remains consistent with the Company s objectives, the Management Performance Committee (Committee) of the Board of Directors routinely:

Retains independent compensation consultants to: (a) review, critique and propose changes in compensation practice when necessary to maintain alignment with the above-listed objectives; (b) conduct and analyze market surveys; and (c) provide input on compensation actions for the Company s top officers;

Reviews and approves AMIP and AMIP II participants, objectives and performance targets for each major business unit;

Reviews the Company s consolidated financial results and the financial and operating results of the Company s major business units;

Evaluates the individual performance of the named executive officers; and

Develops and approves annual and long-term compensation for the Company s executive officers.

The Committee references the market 50th percentile for total compensation for each named executive officer, along with the range of compensation observed among the Company s peers. The Committee defines total compensation as: base salary + AMIP II (or AMIP) target + LTCIP target + value of restricted stock and/or stock options (Equity Awards). The intent is to ensure that each executive s compensation remains competitive within the relevant segment of the natural gas industry, relative to individual factors such as the officer s experience and expertise. In addition to market-survey data, the Committee considers job performance, responsibilities, and advancement potential when setting compensation for each of the named executive officers.

HOW THE COMPANY DEFINES THE MARKET FOR NAMED EXECUTIVES

The Company operates in four major segments of the natural gas industry: (a) exploration and production (E&P); (b) gas gathering and processing; (c) interstate natural gas pipelines; and (d) retail gas distribution. At any given time, the competitive environment for executive compensation may be significantly different in each of these four major segments. In 2007, when setting compensation for each key executive, the Committee, with advice from Hewitt, defined the relevant peer group for that executive. For example, because they have responsibilities for all business units, the peer groups for Messrs. Rattie and Parks include companies in all major segments of the natural gas industry. The peer group for Mr. Stanley includes predominantly E&P companies because he is the chief executive officer of Market Resources, which conducts the Company s E&P activities. In recent years, the competition for executive talent in the E&P segment of the industry has been intense, resulting in a rapid increase in total compensation for E&P executives. Messrs. Allred and Bradley s peer groups consist of natural gas utility companies and interstate pipeline companies. The Committee considers the relative size of companies in the industry peer group in its evaluation of market data. The Committee also compares its officer compensation to general-industry peers, a group of companies, selected by Hewitt, in other industries with median revenue similar to Questar.

INDUSTRY PEER COMPANIES CORPORATE PEER, E&P AND GAS AND PIPELINE GROUPS

To arrive at an estimate of the market 50 th percentile, the Committee designated all of the companies listed below as peers for Messrs. Rattie and Parks. The Committee defined all of the companies listed as (1) to be peers for Mr. Stanley. The Committee determined that all companies listed as (2) would be peers for Messrs. Allred and Bradley.

AGL Resources (2)

Cabot Oil & Gas Corporation (1)

Cimarex Energy Company (1)

CMS Energy Corporation (2)

Dominion Resources, Inc. (2)

El Paso Corporation (2)

EOG Resources, Inc. (1)

Forest Oil Corporation (1)

Great Plains Energy (2)

Newfield Exploration Company (1)

NiSource, Inc. (2)

Noble Energy, Inc. (1)

ONEOK Inc (2)

Peoples Energy Corporation (2)

Pioneer Natural Resources Company (1)

Plains Exploration & Production Company (1)

SCANA Corporation (2)

Southern Union (2)

Southwestern Energy Company (1)

The Williams Companies (1, 2)

In arriving at the 50th percentile for Mr. Bradley, the Committee also considered the compensation for pipeline subsidiary executives at Centerpoint Energy Inc., Enbridge Inc., Spectra Energy Corp. and TransCanada Corp. For Mr. Allred, the Committee also considered the compensation for the heads of utility units at Equitable Resources Inc. and Atmos Energy Corp.

Peer Companies General Industry

These companies were selected by Hewitt and have median revenue similar to Questar s.

ABM Industries, Inc.

Borg Warner, Inc.

Chicago Bridge & Iron Company

Del Monte Foods Company

Ecolab, Inc.

Goodrich Corporation

Martin Marietta Materials, Inc.

McCormick & Company, Inc.

Molson Coors Brewing Company

The Scotts Miracle-Gro Company

Vulcan Materials Company

W. R. Grace & Co.

The Committee sets annual base salary, AMIP or AMIP II target, LTCIP target and Equity Awards for all key executives. Hewitt and the Human Resources Department assist the Committee in the collection and analysis of peer-company data. Mr. Rattie has input into the compensation for all named executive officers except himself.

BASE SALARIES

The Committee establishes base salaries for executives by considering their scope of responsibilities, performance, and competitive market compensation paid by other companies in the executive s peer group. The Committee reviews base salaries for the Company s named executive officers on at least an annual basis. When setting salaries, the Committee considers an estimate of the market 50th percentile for the executive s relevant peer group, along with individual factors and internal comparisons with other Company officers in comparable roles. The Committee uses proxy data and information provided by Hewitt to obtain information about the base salaries paid by peers. In 2007, the average base salary increase for named executive officers was 7.1%.

INCENTIVE COMPENSATION

The Company s named executive officers participate in either AMIP or AMIP II (AMIP II was approved by shareholders in 2005 and applies to those officers covered by Internal Revenue Code Section 162(m)) and the LTCIP (approved by shareholders in 2004). Those officers also receive Equity Awards pursuant to the LTSIP (approved by shareholders in 2001). The Committee intends to put a substantial portion of each officer s compensation at risk. AMIP and AMIP II payouts are tied to annual financial and operating goals set by the Board at the beginning of the plan year. LTCIP payouts are tied to total shareholder returns relative to a pre-set group of peer companies over a three-year period. The intent is to incentivize participating executives to focus on longer-term stock-price appreciation. AMIP, AMIP II and LTCIP are cash plans that can award amounts from zero to a predetermined maximum depending on the Company s results. The Committee believes that its approach effectively aligns the executive officers interests with shareholder interests.

AMIP AND AMIP II

Under AMIP and AMIP II, the Company sets separate performance targets for each major business unit. These business-unit targets are tied to key consolidated financial and operating goals. Each year, the Committee reviews and approves the specific annual performance targets for the Company as a whole, and for each major subsidiary. The performance targets are set at the beginning of each year after a review of that year s budget and the prior-year actual results. Targets are generally higher than results for the prior year and expectations for the current year. For example, the Company earned $2.54[1] per diluted share in 2006. After reviewing management s 2007 business plan, the Committee set the 2007 target at $2.675[1] per diluted share.

2007 PERFORMANCE COMPONENTS AND TARGETS FOR BOTH AMIP AND AMIP II

Questar Market Resources	**Target**
Questar Corporation earnings per share	$2.675[1]
Business unit net income total[2] (millions)	$401
Questar Exploration and Production production volumes (Bcfe)	135
Questar Exploration and Production rate of depletion, depreciation and amortization 3-year average rate	1.48
Questar Pipeline	**Target**
Questar Corporation earnings per share	$2.675[1]
Questar Pipeline net income (millions)	$40.5
Operating & maintenance expenses per Dth of contract demand	$22.30
Achievement of specific strategies and operational initiatives *(e.g.* Southern System Expansion II ready for service 1/1/08)	3 of 5 affirmative answers
Questar Gas	**Target**
Questar Corporation earnings per share	$2.675[1]
Questar Gas net income (millions)	$37.5
Questar Gas customer satisfaction (1-7 scale)	6
Questar Gas annual operating and maintenance expenses per customer	$137.00

[1]Because of a 2007 two-for-one stock split, this number was adjusted.

[2] Questar Market Resources net income was indexed to commodity prices of $6.52 per Mcf for gas and $52.04 per bbl for oil, the then-current market price for natural gas and oil on the date the Committee approved the annual incentive plan goals.

Each year, Mr. Rattie s AMIP II and Mr. Parks AMIP payouts are based 50% on the results for Questar Market Resources and 25% each on the results for Questar Pipeline and Questar Gas. Mr. Stanley s AMIP II payout is based on the results for Questar Market Resources. Mr. Allred s AMIP II payout is based on the results for Questar Gas. Mr. Bradley s AMIP II payout is based on the results for Questar Pipeline.

The Company calculates an overall payout factor, which can range from zero to 200% based on each unit s actual results compared to the measures. Each officer s target bonus is multiplied by the respective payout factor to determine the payment. The maximum cash payment to any officer under the terms of AMIP II is capped at $1 million for fiscal years 2005 through 2008 and $1.5 million for fiscal years 2009 and later. This limit had the effect of capping Mr. Rattie s maximum AMIP II bonus for 2007 at 125% of target and will similarly cap his bonus at 111% of target for 2008. The limit will have the effect of capping Mr. Stanley s bonus at 184% of target in 2008. Each officer s target bonus is a percentage of his annual base salary in effect at the time the target bonus is approved. The Committee, in its sole discretion, can reduce the cash award otherwise payable to an officer. Neither the Committee nor the Company may increase the cash award otherwise payable under the AMIP or AMIP II formula.

The 2007 AMIP or AMIP II targets were as follows for the named executive officers:

Mr. Rattie	100%
Mr. Parks	60%
Mr. Stanley	85%*
Mr. Allred	60%
Mr. Bradley	60%

*This percentage includes the Market Resources Employee Incentive Plan (Market Resources EIP) which applies a 12.5% target. The Market Resources EIP applies to all employees (except those classified as temporary or occasional part-time) who work for Market Resources subsidiaries and are scheduled to work at least 20 hours per week.

In 2007, the Company and its subsidiaries met or exceeded all of the AMIP/AMIP II measures except Questar Gas net income the target was $37.5 million and the actual result was $37.427 million.

LONG-TERM CASH INCENTIVE PLAN

The LTCIP ties compensation for key executives to total shareholder return relative to a mix of peer companies over a longer-term (three-year) performance period. Payouts from the LTCIP increase or decrease based upon the Company s total shareholder return as compared with a group of peer companies. The peer group includes a mix of E&P, pipeline, utility and integrated companies as set forth below.

To determine the payout under the LTCIP, the Company first determines its rank relative to the peer group. The rank is calculated at the end of the three-year performance period. The Company calculates total shareholder return by adding the change in stock price over the period to the dividends paid per share over the period and dividing this sum by the stock price at the beginning of the plan period. In 2007, the Committee modified the Plan design to include a stock-appreciation multiplier in the calculation for performance periods beginning in January 2007 and later. This multiplier is the ending stock price divided by $41.525. The ending stock price is the simple average Company stock price for each trading day in December of the performance period s third year. The maximum payment under the LTCIP for any performance period is capped at $ 1.5 million.

The calculation is as follows:

Target Award x Total Shareholder Return Rank Multiplier x Stock Appreciation Multiplier = LTCIP Payout

For the 2005-2007 and 2006-2008 performance periods, to determine the payout under the LTCIP the Company first determines its rank relative to the peer group. The rank is calculated by averaging the annual total shareholder return for each of the three years in the performance period. The annual total shareholder return is derived by adding the annual change in stock price to the annual dividend per share and dividing this sum by the stock price at the beginning of the year. The year-end stock price is the simple average of the daily closing price of the Company s stock during the month of December. The Company s average annual return is determined by adding the annual return for each of the three years and dividing by three. The Company s average annual return is then ranked compared to the average annual returns for the peer group. The payout to plan participants is based on the ranking. Participants earn the maximum bonus if the Company has the highest average annual shareholder return of its peer group. Participants earn the target bonus if the Company s average annual shareholder return ranks at the midpoint of the peer group. If the Company s average annual shareholder return for the performance period places it in the bottom third of the group, no bonus would be paid under the LTCIP.

For the 2005-2007 performance period, the Committee based the payout on the Company s rank compared to those companies indicated by an asterisk in the group listed below. People s Energy Company, Vintage Petroleum, Inc. and Western Gas Resources Inc. were originally part of this group; all of them subsequently ceased to be publicly traded. In 2007, the Committee modified the LTCIP based on its review and recommendations from Hewitt. The list of peer companies was expanded in 2007 to include more E&P companies, reflecting the Company s strategic intent to grow primarily by reinvestment in its E&P businesses.

The Committee approved the following peer companies for the LTCIP in February 2007:

Cabot Oil and Gas Company*	Noble Energy, Inc.
Chesapeake Energy Corporation	Northwest Natural Gas Company
Devon Energy Corporation*	ONEOK, Inc.*
El Paso Corporation*	Plains Exploration & Production Company
Energen Corporation*	St. Mary Land & Exploration Company
EOG Resources, Inc.*	Southwestern Energy Company*
Equitable Resources, Inc.*	Ultra Petroleum Corporation
Forest Oil Corporation*	Williams Companies, Inc.*
National Fuel Gas Company*	
Newfield Exploration Company	

This list is not identical to the peer list used for total compensation shown earlier in this proxy statement. This difference reflects the need to use only one peer group for all officers under the LTCIP, versus the more tailored and longer total compensation list.

There are currently three outstanding performance periods: 2006 through 2008, 2007 through 2009 and 2008 through 2010. The Company made payments under the LTCIP to the named executive officers for the 2005-2007 period in February 2008, and the amounts are reflected in the Summary Compensation Table, along with amounts paid under AMIP or AMIP II in column (g). For the three-year performance period ending December 31, 2007, the Company s three-year average total shareholder return was 34.86%, which ranked sixth out of the original 16 companies. Three of the peer companies are no longer publicly traded. The calculated payout for the performance period was 157.14% of the target. The payout calculation, which was set at the time the Committee approved the 2005-2007 LTCIP, is based on an assumption that the companies that ceased to be publicly traded during the period ranked at the bottom of the list.

EQUITY AWARDS

The Company s Long-term Stock Incentive Plan (LTSIP) is intended (1) to retain key executives and (2) to ensure that executive officers have a significant incentive to manage the Company with the intent to maximize long-term shareholder returns. The value of the grant to each executive is tied to the Committee s estimate of the market 50th percentile, adjusted to take into account performance and retention considerations.

The Company s primary equity incentive vehicle is restricted stock. On occasion, the Committee has granted and will continue to grant stock options to key executives. In 2007, the Committee granted stock options to Messrs. Rattie and Stanley, due to the competitive nature of the market for their positions and their comparatively short tenure with the Company. The Committee recommended and the Board approved the restricted stock and option grants shown in the Summary Compensation table.

For awards granted in 2007, the vesting schedule of the restricted stock grants for Messrs. Rattie and Stanley is over a five-year period, starting two years after the date of grant with one third of the shares vesting in each of the remaining three years. For the other named executives, the 2007 grants vest over a four-year period, starting one year after the date of grant with one third of the shares vesting in each of the remaining three years. These shares do not automatically vest upon retirement. However, the Committee may amend an agreement to allow for accelerated vesting of restricted stock grants.

The Company typically makes annual equity grants in February. The Committee did not consider or approve any equity grants for named executive officers in 2007 other than in February. The Company does not backdate stock options or alter the exercise price after the grant date. As set forth in the LTSIP, the Board sets the option price at the time the option is granted, and that price cannot be less than the closing price of the Company s common stock on the date of grant. The Committee recommends option grants and the full Board ratifies those grants.

The Committee established stock-ownership guidelines for officers that are a multiple of the individual officer s base salary. Under the guidelines, all named executive officers are required to own shares having a value of at least three times their annual base salary and, in Mr. Rattie s case, eight times his base salary. These guidelines are intended to align the officers interests with those of shareholders, while allowing executive officers some opportunity to diversify their holdings. Phantom stock units attributable to an officer s deferred compensation are counted toward the total. All of the named executive officers own shares in excess of these guidelines.

The Company s Insider Trading Policy prohibits executive officers from short sales, selling options or derivatives covering the Company s securities, and other similar transactions.

EXECUTIVE SEVERANCE COMPENSATION PLAN

The named executive officers participate in the Company s Executive Severance Compensation Plan, which provides for benefits upon qualifying terminations of employment occurring on or following a change in control of the Company. The Company and the Committee believe that this plan helps ensure that the Company attracts and retains the executive talent needed to achieve corporate objectives, particularly assuring that executives direct their attention to their duties, acting in the best interests of the shareholders, notwithstanding the possibility of a change in control. This plan is described, and estimates of payments to the named executives as of December 31, 2007, are set forth in the section entitled Potential Payments upon Termination.

EMPLOYMENT CONTRACTS

The Company entered into employment agreements with Messrs. Rattie and Stanley when they joined the Company in 2001 and 2002 respectively. None of the other named executive officers has an employment contract.

Mr. Rattie signed a new employment contract with the Company effective February 1, 2004, to replace the contract that he originally signed when he joined the Company in 2001. The current contract is on file with the SEC s EDGAR system as Exhibit 10.15 to the Company s 2003 Annual Report on Form 10-K and an amendment is filed as Exhibit 10.21 to an 8-K filed on May 18, 2005. The contract establishes Mr. Rattie s three-year employment period, which originally expired February 1, 2007, but was automatically extended. It also sets forth various termination scenarios (death or disability, cause, without cause, and by the executive) and the methods of calculating the amounts due to Mr. Rattie under each of those scenarios. The contract includes certain restrictive covenants such as non-solicitation of employees and confidentiality that apply upon termination.

The Company s current agreement with Mr. Stanley became effective on February 1, 2004, and replaced the one he signed on February 1, 2002. It is on file with the SEC s EDGAR system as Exhibit 10.16 to the Company s 2003 Annual Report on Form 10-K and an amendment is filed as Exhibit 10.22 to an 8-K filed on May 18, 2005. Its terms are identical to Mr. Rattie s contract except for the amount of compensation and Mr. Stanley s contract specifically limits him to receiving the higher of any payment received under the Company s Executive Severance Plan, or under his employment contract in the event of a change in control, but not both.

The amounts due to both officers under various termination scenarios, calculated as of December 31, 2007, are set forth in the section entitled Potential Payments upon Termination.

QUALIFIED RETIREMENT PLANS

The Company maintains both a defined-contribution retirement plan (the 401(k) Plan) and a defined-benefit retirement plan (the Pension Plan). The named executive officers participate in both of these plans. These plans are described in the narrative to the Retirement Plans section. Mr. Bradley is not yet vested in the Pension Plan.

OTHER BENEFITS

The named executive officers also receive or have the opportunity to participate in other benefit plans offered by the Company to most of its employees. These benefits include medical and dental coverage; participation in a cafeteria plan (which includes flexible health-care spending account and dependent-care spending account features); basic life insurance paid by the employer (providing one-times base salary); supplemental life insurance (up to four-times base salary, but not to exceed $750,000); business-travel accident insurance; catastrophe accident insurance; participation in a long-term disability plan; and the employee-assistance program. The executive officers also receive paid time off, holidays, and are eligible to participate in the Company s short-term disability program, which provides benefits (such as continued salary payments) for leave up to 16 weeks due to the employee s serious health condition.

NONQUALIFIED DEFERRED COMPENSATION PLANS

The Company allows the named executive officers, along with other certain key employees, to defer the receipt of compensation under the Deferred Compensation Wrap Plan (Wrap Plan). The Company and the Committee believe that a deferred compensation program is necessary for hiring and retention purposes. The Wrap Plan includes both a deferred compensation program and a 401(k) supplemental program. The deferred compensation program of the Wrap Plan allows officers and certain key employees to defer a portion of their base salaries and bonuses until termination, death or disability. Most of the deferred amounts may be treated either as if invested in Company stock or as if invested in ten-year U.S. Treasury notes. A specified percentage of amounts deferred also receive a company matching contribution, which is treated as if invested in Company stock. The 401(k) supplemental program of the Wrap Plan allows officers and certain key employees whose compensation has reached the IRS-imposed limit ($225,000 in 2007) to continue to defer 6% of their salary in excess of this limit and to receive a Company match on this deferred amount as if that amount had been invested in the 401(k) Plan. The amounts deferred in this program and the Company match are treated as if invested in Company stock.

The named executive officers also participate in the Supplemental Executive Retirement Plan (SERF), a non-qualified plan, which allows for the receipt and deferral of retirement benefits once the named executive officer s compensation has reached the IRS-imposed limit ($225,000 in 2007) and his or her compensation above the limit cannot be taken into account in determining the qualified pension benefits. The SERF is described in more detail under the Retirement Plan section of the Compensation Tables.

PERQUISITES

The Company limits the perquisites granted to officers and does not reimburse officers for: cars, country-club memberships, supplemental welfare benefit plans, executive dining-room service, or personal use of the Company s airplane. The Company will reimburse officers for up to 70% of costs associated with tax preparation and other personal financial advice up to a cap of $3,000 per year *(i.e.,* a maximum reimbursement of $2,100). During the calendar year of an officer s retirement, the limit is increased to 70% of cost up to a cap of $6,000 *(i.e.,* a maximum reimbursement of $4,200 in the year of retirement).

TAX CONSIDERATIONS

Section 162(m) of the Internal Revenue Code precludes the Company from deducting compensation paid in excess of $1 million per year to any executive officer listed in the Summary Compensation Table except the chief financial officer. Performance-based compensation, however, is not subject to this deductibility limit. When structuring the compensation paid to the Company s named executives, the Committee considers the provisions of this federal tax rule. The Committee has in the past awarded, and may in the future award, compensation that is not deductible if, in the Committee s judgment, doing so is necessary to achieve an appropriate compensation structure.

COMPENSATION TABLES

SUMMARY COMPENSATION TABLE

The following table includes information about compensation for the fiscal years 2006 and 2007, for the chief executive officer, chief financial officer and the three other highest-paid executive officers of the Company.

Name and Principal Position	Year	Salary ($)	Stock Awards ($)[1]	Option Awards ($)[1]	Non-Equity Incentive Plan Compensation ($)[2]	Change in Pension Value and Nonqualified Deferred Compensation Earnings ($)[4]	All Other Compensation ($)[5]	Total ($)
(a)	(b)	(c)	(e)	(f)	(g)	(h)	(i)	(j)
Keith O. Rattie	2007	783,333	770,829	791,473	1,628,560	270,456	18,692	4,263,343
chairman of the Board, president & chief executive officer	2006	687,500	716,097	600,877	1,533,320	395,447	81,262	4,014,503
Stephen E. Parks senior vice president & chief financial officer	2007	318,333	165,559	0	476,895	179,569	17,154	1,157,510
	2006	308,333	233,430	17,234	395,660	450,947	26,966	1,432,570
Charles B. Stanley executive vice president & chief operating officer	2007	620,000	587,262	719,838	1,548,972[3]	148,929	13,700	3,638,701
	2006	558,333	501,627	573,948	1,305,781	204,614	56,334	3,200,637
Alan K. Allred executive vice president	2007	318,333	165,559	0	472,020	272,703	11,000	1,239,615
	2006	305,950	258,252	25,133	416,205	475,054	26,396	1,506,990
R. Allan Bradley senior vice president	2007	262,500	260,167	90,464	318,000	65,444[6]	11,000	1,007,575
	2006	244,167	257,742	210,788	207,500	74,036[6]	18,295	938,492

[1]The stock and option award values consist of the SFAS 123R expense recognized for all unvested share-based compensation. See Note 3 to the consolidated financial statements included in Item 8 of Part II of the Company s 2007 Form 10-K.

[2]Non-equity incentive plan compensation includes payments earned under AMIP or AMIPII for the 2007 performance period and payments earned under the LTCIP for the three-year performance period ending December 31, 2007. Both programs resulted in payments in February 2008.

[3]Mr. Stanley received apayment in February 2008 of $135,942 under the terms of the 2007 Market Resources Employee Incentive Plan.

[4]The amounts in Column (h) represent the actuarial increase in the present value of the named executive officer s benefits under the pension plan and the Supplemental Executive Retirement Plan. These estimates are determined using interest-rate and mortality-rate assumptions consistent with those used in the Company s 2007 Form 10-K.

[5]List of items included in Column (i) of Summary Compensation Table:

	401(k) Employer Match ($)	40 l(k) Employer Non-Matching Contribution ($)	Paid Time Off Sold ($)	Total
Keith O. Rattie	10,800	200	7,692	18,692
Stephen E. Parks	10,800	200	6,154	17,154
Charles B. Stanley	13,500	200		13,700
Alan K. Allred	10,800	200		11,000
R. Allan Bradley	10,800	200		11,000

[6]Mr. Bradley is not yet vested in the Company s Pension Plan.

GRANTS OF PLAN-BASED AWARDS FOR 2007

This table shows the plan-based awards granted to named executives during 2007. For non-equity incentive plans, it sets forth the ranges of possible awards. For stock awards, the table shows the number of shares or option shares granted and the grant date fair values of those awards.

Name	Grant Date	Estimated Future Pay-outs Under Non-Equity Incentive Plan Awards			All Other Stock Awards:	All Other Option Awards:	Exercise or Base Price of	Grant Date Fair
		Threshold[1] ($)	Target ($)	Maximum ($)	Number of Shares of Stock or Units (#)	Number of Securities Under-Lying Options (#)	Option Awards ($/sh)	Value of Stock & Option Awards ($)
(a)	(b)	(c)	(d)	(e)	(i)	(j)	(k)	(1)
Keith O.	02/13/07[1,2]	100,000	400,000	1,200,000	0	0	0	0
	02/13/07	0	0	0	0	80,000	41.08	3,286,000
Rattie	02/13/07[1,3]	20,000	800,000	1,000,000	0	0	0	0
	02/13/07	0	0	0	20,000	0	41.08	821,500
Stephen E.	02/13/07[1,2]	60,000	240,000	720,000	0	0	0	0
	02/13/07[1,3]	4,800	192,000	384,000	0	0	0	0
Parks	02/13/07		0		4,000	0	41.08	164,300
Charles B.								
Stanley &nD>								

4. Accounting for stock-based compensation

Total stock-based compensation expense recognized in the accompanying condensed consolidated statements of operations for the three and six months ended June 30, 2012 and 2011 was as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Stock-based compensation	$ 3,072	$ 1,993	$ 5,951	$ 4,701

On May 17, 2012, the Compensation Committee approved a management proposal designed to encourage employee retention. The proposal involved the grant of stock options and restricted stock units to employees, including executive officers of the Company. 3,942,500 options were granted with vesting terms subject to the achievement of certain performance milestones. 3,942,500 options were granted with time-based vesting terms of 25% every 6 months beginning November 1, 2012, to be fully vested on May 1, 2014. 62,700 options were granted with time-based vesting terms of 25% after one year and ratably on a monthly basis over a period of 36 months thereafter. 50,600 restricted stock units were granted with time-based vesting terms of 25% per year commencing on the first anniversary. The performance-based options, time-based stock options, and restricted stock units had a grant date per share fair value of $0.60, $1.12 and $1.69, respectively.

The Company uses the Black-Scholes option valuation model to estimate the grant date fair value of employee stock options. Restricted stock units are valued based on the market price on the grant date. The Company calculated the fair value of employee stock options for the three months ended June 30, 2012 using the following assumptions:

	Performance-based		Time-based	
Risk-free interest rate	0.20%	0.32%	0.74%	1.16%
Expected lives	1.2	2.1 years	5.6	6.1 years
Volatility	35%	70%	81%	83%
Dividends				

As of June 30, 2012, there was $14.0 million and $11.5 million of unrecognized compensation cost related to options and restricted stock units, respectively, which are expected to be recognized over the remaining weighted average vesting period of 1.9 years. The Company evaluates stock awards with performance conditions as to the probability that the performance conditions will be met and estimates the date at which the performance conditions will be met in order to properly recognize stock-based compensation expense over the requisite service period. As of June 30, 2012, there was $128,000 and $3.7 million of unrecognized expenses related to performance options and restricted stock units, respectively, for milestones not considered probable of achievement.

5. Net loss per common share

Basic net loss per share excludes dilution for potentially dilutive securities and is computed by dividing net loss applicable to common stockholders by the weighted average number of common shares outstanding during the period excluding the shares loaned under the share lending arrangement (see Note 8 Common and preferred stock). As of June 30, 2012, 9,000,000 shares of the Company s common stock, which were loaned to a share borrower pursuant to the terms of a share lending agreement as described in Note 12,

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were issued and are outstanding, and holders of the borrowed shares have all the rights of a holder of the Company s common stock. However, because the share borrower must return all borrowed shares to the Company (or, in certain circumstances, the cash value thereof), the borrowed shares are not considered outstanding for the purpose of computing and reporting basic or diluted earnings (loss) per share. Diluted net loss per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Potentially dilutive securities are excluded from the computation of diluted net loss per share for all of the periods presented in the accompanying condensed consolidated statements of operations because the reported net loss in each of these periods results in their inclusion being antidilutive. Antidilutive securities, which consist of stock options, restricted stock units, warrants, and shares that could be issued upon conversion of the senior convertible notes, that are not included in the diluted net loss per share calculation consisted of an aggregate of 61,741,900 shares and 32,048,936 shares as of June 30, 2012 and 2011, respectively, and exclude the 9,000,000 shares loaned under the share lending arrangement.

6. State research and development credit exchange receivable

The State of Connecticut provides certain companies with the opportunity to exchange certain research and development income tax credit carryforwards for cash in exchange for forgoing the carryforward of the research and development income tax credits. The program provides for an exchange of research and development income tax credits for cash equal to 65% of the value of corporation tax credit available for exchange. Estimated amounts receivable under the program are recorded as a reduction of research and development expenses. At June 30, 2012 and December 31, 2011, the estimated amounts receivable under the program were $658,000 and $473,000, respectively.

7. Property and equipment net

Property and equipment net consist of the following (dollar amounts in thousands):

	Estimated Useful Life (Years)	June 30, 2012	December 31, 2011
Land		$ 5,273	$ 5,273
Buildings	39-40	54,948	54,948
Building improvements	5-40	114,225	114,247
Machinery and equipment	3-15	82,402	83,476
Furniture, fixtures and office equipment	5-10	5,135	5,249
Computer equipment and software	3	12,177	13,049
Leasehold improvements		48	53
Construction in progress		11,187	8,498
		285,395	284,793
Less accumulated depreciation and amortization		(96,236)	(91,764)
Property and equipment net		$ 189,159	$ 193,029

Leasehold improvements are amortized over four years which is the shorter of the term of the lease or the service lives of the improvements.

Depreciation and amortization expense related to property and equipment for the three and six months ended June 30, 2012 and 2011 was as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Depreciation and amortization expense	$ 3,304	$ 3,580	$ 6,661	$ 7,379

8. Common and preferred stock

On February 8, 2012, the Company sold 35,937,500 units in an underwritten public offering, including 4,687,500 units, sold pursuant to the full exercise of an over-allotment option granted to the underwriters, with each unit consisting of one share of common stock and a warrant to purchase 0.6 of a share of common stock. All of the securities were offered by the Company at a combined price to the public of $2.40 per unit and the underwriters purchased the units at a price of $2.256 per unit. Net proceeds from this offering were approximately $80.6 million, excluding any warrant exercises. The 21,562,500 warrants are exercisable at $2.40 per share and expire four years from the date of the issuance (See Note 9 Warrant liability). The shares of common stock and warrants are immediately separable and were issued separately. Concurrent with the underwritten public offering, The Mann Group LLC (The Mann Group) agreed to purchase $77.2 million worth of restricted shares of common stock which will be paid, at the discretion of the Company, by cash or by cancellation of principal indebtedness under the amended loan arrangement, subject to stockholder approval to increase the number of our authorized shares (see Note 11 Related-party arrangements).

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The Company concluded that the Mann Group common stock purchase agreement represented a contingent forward purchase contract that met the definition of a derivative instrument in accordance with ASC 815 *Derivatives and Hedging.* Of the 31,250,000 shares pursuant to the common stock purchase agreement, the portion of the derivative instrument representing 14.7 million shares were recorded as equity (Equity Portion) as they met the criteria for equity classification under ASC 815-40 *Derivatives and Hedging, Contracts in an Entity s Own Stock.* The remaining 16.7 million shares (Non-Equity Portion) required classification outside of equity as the Company did not have sufficient available shares at the time of issuance and at March 31, 2012. The Company revalues the Non-Equity Portion of the forward purchase contract at each reporting date and records a fair value adjustment within Other income . At the time of issuance, the fair value of the forward purchase contract was $2.0 million. The Equity Portion of $0.9 million was classified as equity, and the Non-Equity Portion of $1.1 million was initially recorded to Prepaid expenses and other current assets.

On May 17, 2012, the Company s stockholders approved an increase in its authorized shares of common stock from 250,000,000 to 350,000,000. Accordingly, the shares of common stock needed to consummate the Mann Group common stock purchase agreement became available. As of May 17, 2012, the fair value of the Non-Equity Portion was $13.1 million. As of result of receiving stockholder approval of the increase in authorized shares, the Non-Equity Portion met the criteria for equity classification. Consequently, the Company reclassified the $13.1 million from Prepaid expenses and other current assets to Additional paid-in capital.

The fair value of the forward purchase contract is highly sensitive to the discount applied for lack of marketability and the stock price, and changes in this discount and/or the stock price caused the value of the forward purchase contract to change significantly. As of and for the six months ended June 30, 2012, the Company recognized the change in fair value of $12.0 million in Other income. The Company revalued the Non-Equity Portion using a forward contract valuation formula, in which the forward contract is estimated to be equal to the valuation date stock price of $2.40 at issuance and $1.69 at May 17, 2012 minus the strike price discounted to the valuation date using a risk-free rate of 0.08% at issuance and 0.18% at May 17, 2012. As the shares which would be received upon settlement are currently unregistered, the Company applied a discount for lack of marketability of 10.27% at issuance and 1.67% at May 17, 2012 based on quantitative put models, adjusted to take into account qualitative factors, including the fact that the Company s stock is publicly traded and the fact that there is no contractual restriction on the unregistered shares being registered.

The Company is authorized to issue 350,000,000 shares of common stock, par value $0.01 per share, and 10,000,000 shares of undesignated preferred stock, par value $0.01 per share, issuable in one or more series designated by the Company s board of directors. No other class of capital stock is authorized. As of June 30, 2012 and December 31, 2011, 199,300,833 and 131,522,945 shares of common stock, respectively, were issued and outstanding. Included in the common stock outstanding as of June 30, 2012 are 9,000,000 shares of common stock loaned to Bank of America under a share lending agreement in connection with the offering of the $100.0 million aggregate principal amount of 5.75% Senior Convertible Notes due 2015 (see Note 12 Senior convertible notes). Bank of America is obligated to return the borrowed shares (or, in certain circumstances, the cash value thereof) to the Company on or about the 45th business day following the date as of which the entire principal amount of the notes ceases to be outstanding, subject to extension or acceleration in certain circumstances or early termination at Bank of America s option. The Company did not receive any proceeds from the sale of the borrowed shares by Bank of America, but the Company did receive a nominal lending fee of $0.01 per share from Bank of America for the use of borrowed shares. As of June 30, 2012 the Company had not issued any shares of undesignated preferred stock.

9. Warrant liability

In connection with the sale of units in February 2012, the Company issued separable warrants representing 21,562,500 shares of common stock which are exercisable at $2.40 per share and are exercisable any time prior to February 8, 2016. Warrants representing 60 shares of common stock have been exercised as of June 30, 2012.

Of the 21,562,500 shares represented by warrants, 16,145,833 shares were recorded as equity as they met the criteria for equity classification under ASC 815-40 *Derivatives and Hedging, Contracts in an Entity s Own Stock*. The remaining warrants representing 5,416,667 shares require liability classification in accordance with ASC 480, *Distinguishing Liabilities from Equity,* as the Company did not have sufficient registered shares available at the time of issuance. The fair value of these shares was recorded in accrued expenses and other current liabilities in the condensed consolidated balance sheet. The warrants will be reported as a liability until they are exercised, or at the time that the Company has sufficient registered shares available, at which time the warrants will be adjusted to fair value and reclassified from liabilities to stockholders equity.

The warrants requiring liability classification were recorded at fair value at issuance and will be adjusted to fair value at each reporting period until exercised or expiration. The fair value of the warrant liability at the date of issuance was $7.6 million and was estimated using the Black-Scholes option pricing model, based on the following assumptions: expected dividend yield of 0%; expected volatility of 93%; risk free interest rate of 0.59%; and contractual term of 4.0 years.

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As of March 31, 2012, the fair value of the warrant liability was $7.9 million and was estimated using the Black-Scholes option pricing model based on the following assumptions: expected dividend yield of 0%; expected volatility of 93%; risk-free interest rate of 0.59%; and contractual term of 4 years. Any change in fair value between reporting periods is recorded as other income (expense) in the condensed consolidated statements of operations. During the quarter ended March 31, 2012, a loss of $284,000 was recognized from the fair value adjustment of the warrant liability.

As of June 30, 2012, the fair value of the warrant liability was $4.9 million and was estimated using the Black-Scholes option pricing model based on the following assumptions: expected dividend yield of 0%; expected volatility of 75.7%; risk-free interest rate of 0.41%; and contractual term of 3.6 years. Any change in fair value between reporting periods is recorded as other income (expense) in the condensed consolidated statements of operations. During the quarter ended June 30, 2012, a gain of $3.0 million was recognized from the fair value adjustment of the warrant liability. The fair value of the warrant liability is highly sensitive to the volatility rate used in the option pricing model and an increase in the volatility rate would cause an increase in the warrant liability. The volatility assumption is calculated based on historical activity.

10. Commitments and contingencies

Guarantees and Indemnifications In the ordinary course of its business, the Company makes certain indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. The Company, as permitted under Delaware law and in accordance with its Bylaws, indemnifies its officers and directors for certain events or occurrences, subject to certain limits, while the officer or director is or was serving at the Company s request in such capacity. The term of the indemnification period is for the officer s or director s lifetime. The maximum amount of potential future indemnification is unlimited; however, the Company has a director and officer insurance policy that may enable it to recover a portion of any future amounts paid. The Company believes the fair value of these indemnification agreements is minimal. The Company has not recorded any liability for these indemnities in the accompanying condensed consolidated balance sheets. However, the Company accrues for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is probable and the amount can be reasonably estimated. No such losses have been recorded to date.

Litigation The Company is involved in various legal proceedings and other matters. In accordance with ASC 450 *Contingencies*, the Company records a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated.

The Securities Action. Beginning January 31, 2011, several complaints were filed in the U.S. District Court for the Central District of California against us and four of our officers Alfred E. Mann, Hakan S. Edstrom, Dr. Peter C. Richardson and Matthew J. Pfeffer on behalf of certain purchasers of our common stock. The complaints include claims asserted under Sections 10(b) and 20(a) of the Exchange Act and have been brought as purported shareholder class actions. In general, the complaints allege that the defendants violated federal securities laws by making materially false and misleading statements regarding our business and prospects for AFREZZA, thereby artificially inflating the price of the Company s common stock. The U.S. District Court for the Central District of California has consolidated the pending actions for all purposes and appointed lead counsel.

On July 23, 2012, the Company, while continuing to deny all allegations of wrongdoing or liability whatsoever arising out of the Securities Action, and without in any way admitting fault or liability, entered into a stipulation of settlement to resolve the Securities Action. Subject to preliminary and final approval of the settlement by the U.S. District Court and notice to potential class members, and in exchange for a release of all claims by the class members, among others, and a dismissal of the consolidated lawsuits, the Company has agreed (i) to cause the Company s insurers to pay class members and their attorneys a total of $16 million; and (ii) to issue class members and their attorneys 2,777,778 shares of the Company s common stock. The Company has also agreed that if the consolidated closing bid price for the Company s common stock is below $1.00 per share on the date the U.S. District Court enters an order of final judgment, then the Company will issue class members and their attorneys an additional one million shares of its common stock. Following final approval of the settlement by the U.S. District Court, the shares will be issued pursuant to an exemption from registration provided by Section 3(a)(10) of the Securities Act of 1933, as amended.

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The Derivative Action. In February 2011, shareholder derivative complaints were filed in the Superior Court of California for the County of Los Angeles and in the U.S. District Court for the Central District of California against all of the Company s directors and certain of its officers. The complaints in the shareholder derivative actions allege breaches of fiduciary duties by the defendants and other violations of law. In general, the complaints allege that the defendants caused or allowed for the dissemination of materially false and misleading statements regarding its business and prospects for AFREZZA, thereby artificially inflating the price of its common stock. The Superior Court of California for the County of Los Angeles has consolidated the actions pending before it and appointed lead counsel. The U.S. District Court for the Central District of California has also consolidated the derivative actions pending before it.

On August 3, 2012, the Company, while continuing to deny all allegations of wrongdoing or liability whatsoever arising out of the Derivative Actions and without in any way admitting fault or liability, entered into a stipulation of settlement to resolve the Derivative Action. Subject to preliminary and final approval of the settlement by the U.S. District Court and notice to shareholders, and in an exchange for a release of all claims by the plaintiffs, among others, and a dismissal of the Derivative Actions, the Company has agreed (i) to adopt certain corporate governance measures, (ii) to cause the Company s insurers to pay the plaintiffs attorneys a total of $800,000, and (iii) to issue plaintiffs attorneys 225,000 shares of the Company s common stock. Following final approval of the settlement by the U.S. District Court, the shares will be issued pursuant to an exemption from registration provided by Section 3(a)(10) of the Securities Act of 1933, as amended.

As a result of settlement discussions with the plaintiffs taking place in the latter part of the quarter ended June 30, 2012 and entering into the stipulation of settlement for the Securities Action on July 23, 2012 and for the Derivative Action on August 3, 2012, the Company determined that the liabilities pertaining to both the securities and derivative lawsuits were probable as of June 30, 2012. The Company s financial statements as of and for the three months ended June 30, 2012 reflect the following accruals:

(i) *Cash consideration*. The Company recorded a current liability of $16.8 million under Accrued expense and other current liabilities and a corresponding current asset under Prepaid expenses and other current asset to reflect a receivable from the Company s insurers. The Company has determined that the collectability of the receivable from the insurers is probable. The cash obligation resulted in no charge to the Company s Condensed Consolidated Statements of Operations for the period.

(ii) *Stock consideration*. The Company recorded a charge to General and administrative expenses and an estimated current liability under Accrued expense and other current liabilities of $7.7 million representing the estimated fair value of the 3,002,778 common shares to be issued in the aggregate subject to court approval.

(iii) *Additional stock consideration*. The Company concluded that the contingent obligation to issue an additional one million shares of its common stock, as defined in the stipulation of settlement agreement, met the definition of a derivative instrument in accordance with ASC 815 *Derivatives and Hedging*. The Company estimated the fair value of the derivative instrument using the Monte Carlo simulation model to forecast the contingent obligation applying probabilities that the stock price will be lower than $1.00 based on the following assumptions: expected volatility of 60%, risk free interest rate of 0.16% and final judgment dates ranging from four to six months. As a result, the Company estimated the fair value of this contingent obligation to be immaterial.

11. Related-party arrangements

In October 2007, the Company entered into a $350.0 million loan arrangement with its principal stockholder. In February 2009, the promissory note underlying the loan arrangement was revised as a result of the principal stockholder being licensed as a finance lender under the California Finance Lenders Law. Accordingly, the lender was revised to The Mann Group. Interest accrues on each outstanding advance at a fixed rate equal to the one-year LIBOR rate as reported by the *Wall Street Journal* on the date of such advance plus 3% per annum and is payable quarterly in arrears. The borrowing rate was 4.5% at both June 30, 2012 and December 31, 2011, respectively. In August 2010, the Company amended and restated the promissory note to extend the maturity date from December 31, 2011 to December 31, 2012. In January 2012, the Company amended the note with The Mann Group to extend the maturity date from December 31, 2012 to March 31, 2013 and to extend the date through which the Company can continue to borrow under the amended terms of the note until June 30, 2012. In addition, interest is payable on the first day of the calendar quarter following the calendar quarter in which an advance is made, or such other time as the Company and The Mann Group mutually agree. On May 9, 2012, the Company amended the note with The Mann Group to extend the maturity date of the $350.0 million loan arrangement from March 31, 2013 to July 1, 2013. Under the amended and restated promissory note The Mann Group may require the Company to prepay up to $200.0 million in advances that have been outstanding for at least 12 months. If The Mann Group exercises this right, the Company will have 90 days after The Mann Group provides written notice (or the number of days to maturity of the note if less than 90 days) to prepay such advances. On June 27, 2012, the Company amended the note with the Mann Group to allow accrued and unpaid interest

that becomes due and payable under the note to be paid-in-kind and capitalized into new principal

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indebtedness upon agreement of the parties. In addition, the Company and The Mann Group agreed that the cancelled principal amount related to the common stock purchase agreement (see Note 6 Common and preferred stock) would be permanently retired and not available for re-borrowing under the note. The amendment also extends the date through which the Company can borrow under the note to December 31, 2012.

In August 2010, the Company entered into a letter agreement confirming a previous commitment by The Mann Group to not require the Company to prepay amounts outstanding under the amended and restated promissory note if the prepayment would require the Company to use its working capital resources. In the event of a default, all unpaid principal and interest either becomes immediately due and payable or may be accelerated at The Mann Group s option, and the interest rate will increase to the one-year LIBOR rate calculated on the date of the initial advance or in effect on the date of default, whichever is greater, plus 5% per annum. All borrowings under the loan arrangement are unsecured. The loan arrangement contains no financial covenants. There are no warrants associated with the loan arrangement.

The principal amount outstanding under the loan arrangement as of June 30, 2012, subsequent to the completion of the common stock purchase agreement was as follows (in thousands):

Principal amount outstanding at December 31, 2011	$ 277,216
Borrowings	6,250
Capitalization of accrued and unpaid interest due and payable as of June 27, 2012	11,876
Cancellation of principal indebtedness related to the common stock purchase agreement completed on June 27, 2012	(77,200)
Principal amount outstanding at June 30, 2012	$ 218,142

As of June 30, 2012, the Company had accrued interest of $97,500 related to the remaining principal outstanding and $26.9 million of available borrowings remained under the loan arrangement.

On February 8, 2012, the Company sold $86.3 million worth of units in an underwritten public offering, with each unit consisting of one share of common stock and a warrant to purchase 0.6 of a share of common stock. Concurrent with this public offering, The Mann Group LLC purchased $77.2 million worth of restricted shares of common stock and on June 27, 2012, the Company completed the closing of the sale of 31,250,000 share of its common stock (see Note 8 Common and preferred stock and Note 11 Related-party arrangements).

12. Senior convertible notes

Senior convertible notes consist of the following (in thousands):

	June 30 2012	December 31 2011
Notes due 2013		
Principal amount	$ 115,000	$ 115,000
Unaccreted debt issuance expense	(852)	(1,140)
Net carrying amount	114,148	113,860
Notes due 2015		
Principal amount	$ 100,000	$ 100,000
Unaccreted debt issuance expense	(2,964)	(3,218)
Net carrying amount	97, 036	96,782
Senior convertible notes	$ 211,184	$ 210,642

In August 2010, the Company completed a Rule 144A offering of $100.0 million aggregate principal amount of 5.75% Senior Convertible Notes due 2015. The Notes due 2015 are governed by the terms of an indenture dated as of August 24, 2010 (the 2015 Note Indenture). The Notes due 2015 bear interest at the rate of 5.75% per year on the principal amount, payable in cash semi-annually in arrears on February 15 and August 15 of each year, beginning February 15, 2011. As of June 30, 2012 and December 31, 2011, the Company had accrued interest of $2.2 million related to the Notes due 2015. The Notes due 2015 are general, unsecured, senior obligations of the Company and effectively rank junior in right of payment to all of the Company s secured debt, to the extent of the value of the assets securing such debt, and to the debt and all other liabilities of the Company s subsidiaries. The maturity date of the Notes due 2015 is August 15, 2015 and payment is due in full on that date for unconverted securities. Holders of the Notes due 2015 may convert, at any time prior to the close of business on the business day immediately preceding the stated maturity date, any

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outstanding principal into shares of the Company s common stock at an initial conversion rate of 147.0859 shares per $1,000 principal amount, which is equal to a conversion price of approximately $6.80 per share, subject to adjustment. Except in certain circumstances, if the Company undergoes a fundamental change: (1) the Company will pay a make-whole premium on the Notes due 2015 converted in connection with a fundamental change by increasing the conversion rate on such Notes due 2015, which amount, if any, will be based on the Company s common stock price and the effective date of the fundamental change, and (2) each holder of Notes due 2015 will have the option to require the Company to repurchase all or any portion of such holder s Notes due 2015 at a repurchase price of 100% of the principal amount of the Notes due 2015 to be repurchased plus accrued and unpaid interest, if any. The Company may elect to redeem some or all of the Notes due 2015 if the closing stock price has equaled 150% of the conversion price for at least 20 of the 30 consecutive trading days ending on the trading day before the Company s redemption notice. The redemption price will equal 100% of the principal amount of the Notes due 2015 to be redeemed, plus accrued and unpaid interest, if any, to, but excluding, the redemption date, plus a make-whole payment equal to the sum of the present values of the remaining scheduled interest payments through and including August 15, 2015 (other than interest accrued up to, but excluding, the redemption date). The Company will be obligated to make the make-whole payment on all the Notes due 2015 called for redemption and converted during the period from the date the Company mailed the notice of redemption to and including the redemption date. The Company may elect to make the make-whole payment in cash or shares of its common stock, subject to certain limitations. Under the terms of the 2015 Note Indenture, the conversion option can be net-share settled and the maximum number of shares that could be required to be delivered under the contract, including the make-whole shares, is fixed and less than the number of authorized and unissued shares less the maximum number of shares that could be required to be delivered during the contract period under existing commitments. The Company performed an analysis at the time of the offering of the Notes due 2015 and each reporting date since and has concluded that the number of available authorized shares at the time of the offering and each subsequent reporting date was in excess of the maximum number of shares that could be required to be delivered during the contract period under existing commitments, including the outstanding convertible notes, stock options, restricted stock units, warrants, and other potential common stock issuances. The Company incurred approximately $4.2 million in issuance costs which are recorded as an offset to the Notes due 2015 in the accompanying condensed consolidated balance sheets. These costs are being amortized to interest expense using the effective interest method over the term of the Notes due 2015.

In December 2006, the Company completed a registered offering of $115.0 million aggregate principal amount of 3.75% Senior Convertible Notes due 2013. The Notes due 2013 are governed by the terms of an indenture dated as of November 1, 2006 and a First Supplemental Indenture, dated as of December 12, 2006 (the 2013 Note Indenture). The Notes due 2013 bear interest at the rate of 3.75% per year on the principal amount, payable in cash semi-annually in arrears on June 15 and December 15 of each year, beginning June 15, 2007. As of June 30, 2012 and December 31, 2011, the Company had accrued interest of $192,000 related to the Notes due 2013. The Notes due 2013 are general, unsecured, senior obligations of the Company and effectively rank junior in right of payment to all of the Company s secured debt, to the extent of the value of the assets securing such debt, and to the debt and all other liabilities of the Company s subsidiaries. The maturity date of the Notes due 2013 is December 15, 2013 and payment is due in full on that date for unconverted securities. Holders of the Notes due 2013 may convert, at any time prior to the close of business on the business day immediately preceding the stated maturity date, any outstanding principal into shares of the Company s common stock at an initial conversion rate of 44.5002 shares per $1,000 principal amount, which is equal to a conversion price of approximately $22.47 per share, subject to adjustment. Except in certain circumstances, if the Company undergoes a fundamental change: (1) the Company will pay a make-whole premium on the Notes due 2013 converted in connection with a fundamental change by increasing the conversion rate on such Notes, which amount, if any, will be based on the Company s common stock price and the effective date of the fundamental change, and (2) each holder of Notes due 2013 will have the option to require the Company to repurchase all or any portion of such holder s Notes at a repurchase price of 100% of the principal amount of the Notes to be repurchased plus accrued and unpaid interest, if any. Under the terms of the 2013 Note Indenture, the conversion option can be net-share settled and the maximum number of shares that could be required to be delivered under the contract, including the make-whole shares, is fixed and less than the number of authorized and unissued shares less the maximum number of shares that could be required to be delivered during the contract period under existing commitments. The Company performed an analysis at the time of the offering of the Notes due 2013 and each reporting date since and has concluded that the number of available authorized shares at the time of the offering and each subsequent reporting date was in excess of the maximum number of shares that could be required to be delivered during the contract period under existing commitments, including the outstanding convertible notes, stock options, restricted stock units, warrants, and other potential common stock issuances.

The Company incurred approximately $3.7 million in issuance costs which are recorded as an offset to the Notes due 2013 in the accompanying condensed consolidated balance sheets. These costs are being amortized to interest expense using the effective interest method over the term of the Notes due 2013.

Amortization of debt issuance expense in connection with the offerings of the Notes due 2015 and the Notes due 2013 during the three and six months ended June 30, 2012 and 2011 was as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Amortization expense	$ 343	$ 324	$ 682	$ 644

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13. Income taxes

As required by ASC 740 *Income Taxes* (ASC 740), management of the Company has evaluated the positive and negative evidence bearing upon the realizability of its deferred tax assets. Management has concluded, in accordance with the applicable accounting standards, that it is more likely than not that the Company may not realize the benefit of its deferred tax assets due to its history of operating losses. Accordingly, the net deferred tax assets have been fully reserved.

ASC 740-10-25 *Income Taxes Recognition* clarifies the accounting and disclosure for uncertainty in tax positions, as defined. This guidance seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. The Company believes that its income tax filing positions and deductions will be sustained on audit and does not anticipate any adjustments that will result in a material change to its financial position. Therefore, no reserves for uncertain income tax positions have been recorded pursuant to this guidance. Tax years since 1993 remain subject to examination by the major tax jurisdictions in which the Company is subject to tax.

14. Subsequent event

On July 23, 2012, the Company entered into a stipulation of settlement to resolve the consolidated class action securities lawsuits. The current and former officers and directors named as individual defendants in the consolidated lawsuits have also entered into the stipulation of settlement which remains subject to preliminary and final approval by the U.S. District Court.

Subject to preliminary and final approval of the settlement by the U.S. District Court, and in exchange for a release of all claims by the class members, among others, and a dismissal of the consolidated lawsuits, the Company has agreed (i) to cause its insurers to pay class members and their attorneys a total of $16 million; and (ii) to issue to class members and their attorneys 2,777,778 shares of the Company s common stock. The Company has also agreed that if the consolidated closing bid price for its common stock is below $1.00 per share on the date the U.S. District Court enters an order of final judgment, then the Company will issue class members and their attorneys an additional one million shares of its common stock.

On August 3, 2012, the Company, while continuing to deny all allegations of wrongdoing or liability whatsoever arising out of the Derivative Actions, and without in any way admitting fault or liability, entered into a stipulation of settlement to resolve the Derivative Actions. Subject to preliminary and final approval of the settlement by the U.S. District Court and notice to shareholders, and in an exchange for a release of all claims by the plaintiffs, among others, and a dismissal of the Derivative Actions, the Company has agreed (i) to adopt certain corporate governance measures, (ii) to cause the Company s insurers to pay the plaintiffs attorneys a total of $800,000, and (iii) to issue plaintiffs attorneys 225,000 shares of the Company s common stock. Following final approval of the settlement by the U.S. District Court, the shares will be issued pursuant to an exemption from registration provided by Section 3(a)(10) of the Securities Act of 1933, as amended.

As a result of settlement discussions with the plaintiff taking place in the latter part of the quarter ended June 30, 2012 and entering into the stipulation of settlement for Securities Action on July 23, 2012 and for the Derivative Action on August 3, 2012, the Company determined that the liabilities pertaining to both the securities and derivative lawsuits were probable as of June 30, 2012. Accordingly, the Company recorded a litigation settlement accrual in its financial statements as of and for the three months ended June 30, 2012 (see Note 10 Commitments and contingencies).

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

The following discussion contains forward-looking statements, which involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth below in Part II, Item 1A Risk Factors and elsewhere in this quarterly report on Form 10-Q. These interim condensed consolidated financial statements and this Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the financial statements and notes for the year ended December 31, 2011 and the related Management s Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in the Annual Report. Readers are cautioned not to place undue reliance on forward-looking statements. The forward-looking statements speak only as of the date on which they are made, and we undertake no obligation to update such statements to reflect events that occur or circumstances that exist after the date on which they are made.

OVERVIEW

We are a biopharmaceutical company focused on the discovery, development and commercialization of therapeutic products for diseases such as diabetes and cancer. Our lead product candidate, AFREZZA (insulin human [rDNA origin]) inhalation powder, is an ultra rapid-acting insulin

that is in late-stage clinical investigation for the treatment of adults with type 1 or type 2 diabetes for the control of hyperglycemia.

In January 2011, we received a second Complete Response letter in which the FDA requested that we conduct two clinical studies with the Dreamboat inhaler (one in patients with type 1 diabetes and one in patients with type 2 diabetes), with at least one trial including a treatment group using the MedTone inhaler in order to obtain a head-to-head comparison of the pulmonary safety data for

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the two devices. By the fourth quarter of 2011, we were recruiting subjects into both studies. We expect to complete screening for these studies during the third quarter of 2012 and complete the treatment stage of the studies in the second quarter of 2013. We then would expect to submit the results to the FDA as an amendment to our NDA during in the third quarter of 2013. However, the data collected from these clinical trials may not reach statistical significance or otherwise be sufficient to support an amendment to our NDA, or FDA approval. Moreover, there can be no assurance that we will satisfy all of the FDA s requirements with these two clinical studies or that the FDA will ultimately find our proposed approach to these clinical studies acceptable. The FDA could also request that we conduct additional clinical studies beyond the currently planned studies in order to provide sufficient data for approval of AFREZZA.

We are a development stage enterprise and have incurred significant losses since our inception in 1991. As of June 30, 2012, we have incurred a cumulative net loss of $2.0 billion and an accumulated stockholders deficit of $244.4 million. To date, we have not generated any product revenues and have funded our operations primarily through the sale of equity securities, convertible debt securities and borrowings under our related party loan. As discussed below in Liquidity and Capital Resources, this raises substantial doubt about our ability to continue as a going concern.

We have held extensive discussions with a number of pharmaceutical companies concerning a potential strategic business collaboration for AFREZZA. To date we have not reached an agreement on a collaboration with any of these companies. There can be no assurance that any such collaboration will be available to us on a timely basis or on acceptable terms, if at all.

We do not expect to record sales of any product prior to regulatory approval and commercialization of AFREZZA. We currently do not have the required approvals to market any of our product candidates, and we may not receive such approvals. We may not be profitable even if we succeed in commercializing any of our product candidates. We expect to make substantial expenditures and to incur additional operating losses for at least the next several years as we:

- continue the clinical development of AFREZZA and new inhalation systems for the treatment of diabetes;
- seek regulatory approval to sell AFREZZA in the United States and other markets;
- seek development and commercialization collaborations for AFREZZA; and
- develop additional applications of our proprietary Technosphere platform technology for the pulmonary delivery of other drugs.

Our business is subject to significant risks, including but not limited to the risks inherent in our ongoing clinical trials and the regulatory approval process, our potential inability to enter into sales and marketing collaborations or to commercialize our lead product candidate in a timely manner, the results of our research and development efforts, competition from other products and technologies and uncertainties associated with obtaining and enforcing patent rights.

RESEARCH AND DEVELOPMENT EXPENSES

Our research and development expenses consist mainly of costs associated with the clinical trials of our product candidates that have not yet received regulatory approval for marketing and for which no alternative future use has been identified. This includes the salaries, benefits and stock-based compensation of research and development personnel, raw materials, such as insulin purchases, laboratory supplies and materials, facility costs, costs for consultants and related contract research, licensing fees, and depreciation of

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laboratory equipment. We track research and development costs by the type of cost incurred. We partially offset research and development expenses with the recognition of estimated amounts receivable from the State of Connecticut pursuant to a program under which we can exchange qualified research and development income tax credits for cash.

Our research and development staff conducts our internal research and development activities, which include research, product development, clinical development, manufacturing and related activities. This staff is located in our facilities in Valencia, California; Paramus, New Jersey; and Danbury, Connecticut. We expense research and development costs as we incur them.

Clinical development timelines, likelihood of success and total costs vary widely. We are focused primarily on advancing AFREZZA through regulatory filings. Based on the results of preclinical studies, we plan to develop additional applications of our Technosphere technology. Additionally, we anticipate that we will continue to determine which research and development projects to pursue, and how much funding to direct to each project, on an ongoing basis, in response to the scientific and clinical success of each product candidate. We cannot be certain when any revenues from the commercialization of our products will commence.

At this time, due to the risks inherent in the clinical trial process and given the early stage of development of our product candidates other than AFREZZA, we are unable to estimate with any certainty the costs that we will incur in the continued development of our product candidates for commercialization. The costs required to complete the development of AFREZZA will be largely dependent on the cost and efficiency of our clinical trial operations and discussions with the FDA regarding its requirements.

GENERAL AND ADMINISTRATIVE EXPENSES

Our general and administrative expenses consist primarily of salaries, benefits and stock-based compensation for administrative, finance, business development, human resources, legal and information systems support personnel. In addition, general and administrative expenses include professional service fees and business insurance costs, and litigation settlement charges.

CRITICAL ACCOUNTING POLICIES

There have been no material changes to our critical accounting policies as described in Item 7 of our Annual Report on Form 10-K.

RESULTS OF OPERATIONS

Three and six months ended June 30, 2012 and 2011

Revenues

We did not recognize any revenue for the three months ended June 30, 2012 and 2011 or for the six months ended June 30, 2012. We recognized revenue of $50,000 under a license agreement for the six months ended June 30, 2011. We do not anticipate sales of any product prior to regulatory approval and commercialization of AFREZZA.

Research and Development Expenses

The following table provides a comparison of the research and development expense categories for the three and six months ended June 30, 2012 and 2011 (dollars in thousands):

	Three months ended June 30,			
	2012	2011	$ Change	% Change
Clinical	$ 13,327	$ 6,175	$ 7,152	116%
Manufacturing	9,899	21,131	(11,232)	(53%)
Research	2,182	2,525	(343)	(14%)
Research and development tax credit	(93)	(157)	64	(41%)
Stock-based compensation expense	1,323	622	701	(113%)

Research and development expenses	$ 26,638	$ 30,296	$ (3,658)	(12)%

	Six months ended June 30,			
	2012	2011	$ Change	% Change
Clinical	$ 24,206	$ 12,624	$ 11,582	92%
Manufacturing	19,992	35,460	(15,468)	(44%)
Research	4,122	6,737	(2,616)	(39%)
Research and development tax credit	(185)	(256)	71	(28%)
Stock-based compensation expense	2,659	2,019	640	32%
Research and development expenses	$ 50,794	$ 56,585	$ (5,791)	(10%)

The decrease in research and development expenses for the three months ended June 30, 2012, as compared to the three months ended June 30, 2011, was primarily due to the letter agreement that was entered into between us and N.V. Organon, or Organon, now a

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subsidiary of Merck, in June 2011 to settle a dispute that arose between us and Organon in connection with the termination by us of the Supply Agreement. In connection with the letter agreement, we received the first of two shipments of recombinant human insulin from Organon and paid the first $8.0 million installment. During the 2011 quarter, we expensed $4.3 million for insulin received and recorded $3.7 million for a contract cancellation fee. Additionally, we recorded a loss contingency as of June 30, 2011 of $3.9 million representing the portion of the second $8.0 million payment related to the contract cancellation fee. In total, we expensed $11.9 million in 2011 in connection with termination of the Supply Agreement and receipt of the last insulin shipment. This decrease along with decreased salary related costs of $398,000 as a result of the February 2011 reduction in force was partially offset by increased clinical trial related expenses of $7.5 million in connection with studies 171 and 175 which began enrollment in latter 2011 and increased stock based compensation expenses of $701,000 resulting from special stock awards issued to employees.

Total research and development expenses for the six months ended June 30, 2012 decreased as compared to the six months ended June 30, 2011, primarily due to the $11.9 million expensed in 2011 related to the termination of the Supply Agreement and receipt of the last insulin shipment, restructuring costs of $4.8 million and $2.8 million in stock based compensation expense related to the February 2011 reduction in force offset by $13.9 million of increased clinical trial related expenses in connection with studies 171 and 175 being conducted in 2012.

We anticipate that our overall research and development expenses will increase in 2012 as a result of our ongoing clinical trials.

General and Administrative Expenses

The following table provides a comparison of the general and administrative expense categories for the three and six months ended June 30, 2012 and 2011 (dollars in thousands):

	Three months ended June 30,			
	2012	2011	$ Change	% Change
Salaries, employee related and other general expenses	$ 7,920	$ 7,519	$ 401	5%
Charge for litigation settlement	7,747		7,747	
Stock-based compensation expense	1,749	1,371	378	28%
General and administrative expenses	$ 17,416	$ 8,890	$ 8,526	96%

	Six months ended June 30,			
	2012	2011	$ Change	% Change
Salaries, employee related and other general expenses	$ 16,155	$ 17,970	$ (1,815)	(10%)
Charge for litigation settlement	7,747		7,747	
Stock-based compensation expense	3,291	2,682	609	23%
General and administrative expenses	$ 27,193	$ 20,652	$ 6,541	(32%)

General and administrative expenses for the three months ended June 30, 2012 increased as compared to the same period in the prior year primarily due to an estimated charge for litigation settlement of $7.7 million, increased professional fees of $366,000 related to our defense of litigation, increased consulting fees of $150,000 related to the marketing of Afrezza, and increased stock based compensation expense of $378,000 resulting from special awards issued to employees, offset by decreased salary related costs of $260,000 as a result of the February 2011 reduction in force. For the six months ended June 30, 2012 compared to the same period in the prior year, general and administrative expenses increased due to an estimated charge for litigation settlement of $7.7 million, increased professional fees of $405,000 million related to our defense of litigation, increased consulting fees of $230,000 related to the marketing of Afrezza, offset by decreased salary related costs of $2.5 million as a result of the February 2011 reduction in force.

Other Income

Other income for the three months ended June 30, 2012 increased by $13.3 million as compared to the same period in the prior year due to a gain of $3.0 million recognized resulting from the fair value adjustment of the warrant liability, with the remaining increase primarily due to the adjustment in fair value of the forward purchase contract. Other income for the six months ended June 30, 2012 increased by $13.3 million as compared to the same period in the prior year primarily due to a $12.0 million gain recognized to reflect the adjustment in fair value of the forward purchase contract and a gain of $2.7 million recognized resulting from the fair value adjustment of the warrant liability, partially offset by a realized gain of $1.3 million on foreign exchange hedging contracts recognized for the six months ended June 30, 2011.

Interest Expense

Interest expense for the three and six months ended June 30, 2012 increased by $0.5 million and $1.1 million, respectively, as compared to the same period in the prior year primarily due to the interest expense associated with additional principal drawn down on our note payable to our principal stockholder.

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LIQUIDITY AND CAPITAL RESOURCES

We have funded our operations primarily through the sale of equity securities, convertible debt securities and borrowings under our related party note.

In October 2007, we entered into a loan arrangement with our principal stockholder allowing us to borrow up to a total of $350.0 million. In February 2009, as a result of our principal stockholder being licensed as a finance lender under the California Finance Lenders Law, the promissory note underlying the loan arrangement was revised to reflect the lender as The Mann Group LLC, an entity controlled by our principal stockholder. Interest will accrue on each outstanding advance at a fixed rate equal to the one-year LIBOR rate as reported by the *Wall Street Journal* on the date of such advance plus 3% per annum and is payable quarterly in arrears. In August 2010, we amended and restated the existing promissory note evidencing the loan arrangement with The Mann Group to extend the maturity date from December 31, 2011 to December 31, 2012. In January 2012, we amended the note with The Mann Group to extend the maturity date from December 31, 2012 to March 31, 2013 and to extend the date through which we can continue to borrow under the amended terms of the note until June 30, 2012. In addition, interest is payable on the first day of the calendar quarter following the calendar quarter in which an advance is made, or such other time as we mutually agree. On May 9, 2012, we amended the note with The Mann Group to extend the maturity date from March 31, 2013 to July 1, 2013. Under the amended and restated promissory note, The Mann Group can require us to prepay up to $200.0 million in advances that have been outstanding for at least 12 months. If The Mann Group exercises this right, we will have 90 days after The Mann Group provides written notice (or the number of days to maturity of the note if less than 90 days) to prepay such advances. On June 27, 2012, we amended the note with the Mann Group to allow accrued and unpaid interest that becomes due and payable under the note to be paid-in-kind and capitalized into new principal indebtedness upon mutual agreement. In addition, we and The Mann Group agreed that the cancelled principal amount related to the common stock purchase agreement as described below would be permanently retired and not available for re-borrowing under the note. The amendment also extends the date through which we can borrow under the note to December 31, 2012.

In August 2010, we and The Mann Group entered into a letter agreement confirming a previous commitment by The Mann Group to not require us to prepay amounts outstanding under the amended and restated promissory note if the prepayment would require us to use our working capital resources. In the event of a default, all unpaid principal and interest either becomes immediately due and payable or may be accelerated at the lender s option, and the interest rate will increase to the one-year LIBOR rate calculated on the date of the initial advance or in effect on the date of default, whichever is greater, plus 5% per annum. All borrowings under the loan arrangement are unsecured. The loan arrangement contains no financial covenants. As of June 30, 2012, the amount borrowed and outstanding under the arrangement was $218.1 million and we had $26.9 million of available borrowings under the arrangement.

In August 2010, we completed a Rule 144A offering of $100.0 million aggregate principal amount of 5.75% Senior Convertible Notes due 2015. The net proceeds to us from the sale of the notes were approximately $95.8 million, after deducting the discount to the initial purchasers of $3.3 million and the offering expenses paid by us.

In connection with the offering of the notes, in August 2010, we entered into a share lending agreement with Bank of America, pursuant to which we lent 9,000,000 shares of our common stock to Bank of America, which is obligated to return the borrowed shares (or, in certain circumstances, the cash value thereof) to us on or about the 45th business day following the date as of which the entire principal amount of the notes ceases to be outstanding, subject to extension or acceleration in certain circumstances or early termination at Bank of America s option.

Also in August 2010, we entered into an underwriting agreement with Merrill Lynch and Bank of America, pursuant to which the borrowed shares were offered and sold to the public at a fixed price of $5.55 per share. We did not receive any proceeds from the sale of the borrowed shares to the public, but received a lending fee of $90,000 pursuant to the share lending agreement for the use by Bank of America of the borrowed shares. Bank of America received all of the net proceeds from the sale of the borrowed shares to the public.

On February 8, 2012, we sold $86.3 million worth of units in an underwritten public offering, with each unit consisting of one share of common stock and a warrant to purchase 0.6 of a share of common stock, and reflects the full exercise of an over-allotment option granted to the underwriters. Net proceeds from this offering were approximately $80.6 million, excluding any warrant exercises. Concurrent with this public offering, The Mann Group LLC agreed to purchase $77.2 million worth of restricted shares of common stock which was issued on June 27, 2012 upon cancellation of principal indebtedness of $77.2 million, along with capitalization into new principal indebtedness of accrued and unpaid interest due and payable as of June 27, 2012 of approximately $11.9 million in the aggregate.

During the six months ended June 30, 2012, we used $57.5 million of cash for our operations and had a net loss $74.8 million, of which $13.3 million consisted of non-cash charges such as depreciation and amortization, and stock-based compensation. By comparison, during the six months ended June 30, 2011, we used $67.4 million of cash for our operations and had a net loss of $86.0 million, of which $12.7 million consisted of non-cash charges such as depreciation and amortization, and stock-based compensation. Cash used for our operations for the six months ended June 30, 2012 decreased by $9.9 million compared to cash used for our operations for the six months ended June 30, 2011 due

primarily to termination of a supply agreement in 2011 offset by an increase in clinical trial related expenses in 2012. We expect our negative operating cash flow to continue at least until we obtain regulatory approval and achieve commercialization of AFREZZA.

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We used $0.4 million of cash for investing activities during the six months ended June 30, 2012, compared to $2.2 million for the six months ended June 30, 2011, primarily to purchase machinery and equipment to expand our manufacturing operations and our quality systems that support clinical trials for AFREZZA. Cash used in investing activities for the six months ended June 30, 2012 decreased $1.8 million compared to the same period in prior year due to $3.8 million in proceeds received from the early termination of certificates of deposit that were previously held as collateral for foreign exchange hedging instruments during the six months ended June 30, 2011 offset by $5.7 million in increased purchases of machinery and equipment in the first half of 2011.

Our financing activities generated $86.8 million of cash for the six months ended June 30, 2012, compared to $28.4 million for the same period in 2011. For the six months ended June 30, 2012, cash from financing activities was primarily from $80.6 million related to the February 2012 issuance of common stock and warrants through the sale of 35,937,500 units, with each unit consisting of one share of common stock and a warrant to purchase 0.6 of a share of common stock as well as the exercise of stock options. Additionally we generated cash of $6.3 million from related party borrowings. For the six months ended June 30, 2011, cash from financing activities was primarily from related party borrowings and the sale of common stock to Seaside during the first quarter of 2011 as well as the exercise of stock options.

As of June 30, 2012, we had $32.0 million in cash, cash equivalents and available for sale securities and a $350,000 of certificate of deposit held as collateral for commercial credit card program. We believe our existing cash resources, including the $26.9 million remaining available under our loan arrangement with The Mann Group, will be sufficient to fund our anticipated cash requirements into the fourth quarter of 2012. Accordingly, we will need to raise additional capital, either through the sale of equity or debt securities, the entry into a strategic business collaboration with a pharmaceutical or biotechnology company, the establishment of other funding facilities, licensing arrangements, asset sales or other means, or an increase in the borrowings available under the loan arrangement with our related party, in order to continue the development and commercialization of AFREZZA and other product candidates and to support our other ongoing activities. This raises substantial doubt about our ability to continue as a going concern.

We intend to use our capital resources to continue the development and commercialization of AFREZZA, if approved. In addition, we are expending a portion of our capital to scale up our manufacturing capabilities in our Danbury facilities. We also intend to use our capital resources for general corporate purposes.

We have held extensive discussions with a number of pharmaceutical companies concerning a potential strategic business collaboration for AFREZZA. We cannot predict when, if ever, we could conclude an agreement with a partner. There can be no assurance that any such collaboration will be available to us on a timely basis or on acceptable terms, if at all.

If we enter into a strategic business collaboration with a pharmaceutical or biotechnology company, we would expect, as part of the transaction, to receive additional capital. In addition, we expect to pursue the sale of equity and/or debt securities, or the establishment of other funding facilities. Issuances of debt or additional equity could impact the rights of our existing stockholders, dilute the ownership percentages of our existing stockholders and may impose restrictions on our operations. These restrictions could include limitations on additional borrowing, specific restrictions on the use of our assets as well as prohibitions on our ability to create liens, pay dividends, redeem our stock or make investments. We also may seek to raise additional capital by pursuing opportunities for the licensing, sale or divestiture of certain intellectual property and other assets, including our Technosphere technology platform. There can be no assurance, however, that any strategic collaboration, sale of securities or sale or license of assets will be available to us on a timely basis or on acceptable terms, if at all. If we are unable to raise additional capital, we may be required to enter into agreements with third parties to develop or commercialize products or technologies that we otherwise would have sought to develop independently, and any such agreements may not be on terms as commercially favorable to us.

However, we cannot provide assurances that our plans will not change or that changed circumstances will not result in the depletion of our capital resources more rapidly than we currently anticipate. If planned operating results are not achieved or we are not successful in raising additional capital through equity or debt financing or entering a business collaboration, we may be required to reduce expenses through the delay, reduction or curtailment of our projects, including AFREZZA development activities, or further reduction of costs for facilities and administration, and there will continue to be substantial doubt about our ability to continue as a going concern.

Off-Balance Sheet Arrangements

As of June 30, 2012 we did not have any off-balance sheet arrangements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk related to changes in interest rates impacting our short-term investment portfolio as well as the interest rate on our credit facility with The Mann Group. The interest rate on our credit facility with The Mann Group is a fixed rate equal to

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the one-year LIBOR rate as reported by the *Wall Street Journal* on the date of such advance plus 3% per annum. Our current policy requires us to maintain a highly liquid short-term investment portfolio consisting mainly of U.S. money market funds and investment-grade corporate, government and municipal debt. None of these investments is entered into for trading purposes. Our cash is deposited in and invested through highly rated financial institutions in North America. Our available for sale securities at June 30, 2012 are comprised of a certificate of deposit. We continue to utilize our $350.0 million credit facility to fund operations. As of June 30, 2012, the amount borrowed and outstanding under the credit facility was $218.1 million, with $26.9 million of available borrowings. The interest rate is fixed at the time of the draw. If interest rates were to increase from levels at June 30, 2012 we could experience a higher level of interest expense than assumed in our current operating plan.

ITEM 4. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Our chief executive officer and chief financial officer performed an evaluation under the supervision and with the participation of our management, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act) as of June 30, 2012. Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

An evaluation was also performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of any change in our internal control over financial reporting that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. That evaluation did not identify any change in our internal control over financial reporting during the fiscal quarter ended June 30, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Litigation The Company is involved in various legal proceedings and other matters. In accordance with ASC 450 *Contingencies*, the Company records a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated.

The Securities Action. Beginning January 31, 2011, several complaints were filed in the U.S. District Court for the Central District of California against us and four of our officers Alfred E. Mann, Hakan S. Edstrom, Dr. Peter C. Richardson and Matthew J. Pfeffer on behalf of certain purchasers of our common stock. The complaints include claims asserted under Sections 10(b) and 20(a) of the Exchange Act and have been brought as purported shareholder class actions. In general, the complaints allege that the defendants violated federal securities laws by making materially false and misleading statements regarding our business and prospects for AFREZZA, thereby artificially inflating the price of our common stock. The U.S. District Court for the Central District of California has consolidated the pending actions for all purposes and appointed lead counsel. We refer to the consolidated federal securities actions as the Securities Action.

On July 23, 2012, the defendants, while continuing to deny all allegations of wrongdoing or liability whatsoever arising out of the Securities Action, and without in any way admitting fault or liability, entered into a stipulation of settlement to resolve the Securities Action. Subject to preliminary and final approval of the settlement by the U.S. District Court and notice to potential class members, and in exchange for a release of all claims by the class members, among others, and a dismissal of the consolidated lawsuits, we have agreed (i) to cause our insurers to pay class members and their attorneys a total of $16 million; and (ii) to issue class members and their attorneys 2,777,778 shares of our common stock. We have also agreed that if the consolidated closing bid price for our common stock is below $1.00 per share on the date the U.S. District Court enters an order of final judgment, then we will issue class members and their attorneys an additional one million shares of our common

stock. Following final approval of the settlement by the U.S. District Court, the shares will be issued pursuant to an exemption from registration provided by Section 3(a)(10) of the Securities Act of 1933, as amended.

The Derivative Action. In February 2011, shareholder derivative complaints were filed in the Superior Court of California for the County of Los Angeles and in the U.S. District Court for the Central District of California against all of our directors and certain of our officers. The complaints in the shareholder derivative actions allege breaches of fiduciary duties by the defendants and other violations of law. In general, the complaints allege that the defendants caused or allowed for the dissemination of materially false and misleading statements regarding our business and prospects for AFREZZA, thereby artificially inflating the price of our common

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stock. The Superior Court of California for the County of Los Angeles has consolidated the actions pending before it and appointed lead counsel. We refer to the consolidated state derivative actions as the State Derivative Action. The U.S. District Court for the Central District of California has also consolidated the derivative actions pending before it. We refer to the consolidated federal derivative actions as the Federal Derivative Action. We refer to the State Derivative Action and the Federal Derivative Action collectively as the Derivative Actions.

On August 3, 2012, the defendants, while continuing to deny all allegations of wrongdoing or liability whatsoever arising out of the Derivative Action, and without in any way admitting fault or liability, entered into a stipulation of settlement to resolve the Derivative Action. Subject to preliminary and final approval of the settlement by the U.S. District Court and notice to shareholders, and in an exchange for a release of all claims by the plaintiffs, among others, and a dismissal of the Derivative Actions, we have agreed (i) to adopt certain corporate governance measures, (ii) to cause our insurers to pay the plaintiffs attorneys a total of $800,000, and (iii) to issue plaintiffs attorneys 225,000 shares of our common stock. Following final approval of the settlement by the U.S. District Court, the shares will be issued pursuant to an exemption from registration provided by Section 3(a)(10) of the Securities Act of 1933, as amended.

As a result of settlement discussions with the plaintiffs taking place in the latter part of the quarter ended June 30, 2012 and entering into the stipulation of settlement for Securities Action on July 23, 2012 and for the Derivative Action on August 3, 2012, the Company determined that the liabilities pertaining to both the securities and derivative lawsuits were probable as of June 30, 2012. The Company s financial statements as of and for the three months ended June 30, 2012 reflect the following accruals:

(i) *Cash consideration*. The Company recorded a current liability of $16.8 million under Accrued expense and other current liabilities and a corresponding current asset under Prepaid expenses and other current asset to reflect a receivable from the Company s insurers. The Company has determined that the collectability from the insurers is probable. The cash obligation resulted in no charge to the Company s Condensed Consolidated Statements of Operations for the period.

(ii) *Stock consideration*. The Company recorded a charge to General and administrative expenses and an estimated current liability under Accrued expense and other current liabilities of $7.7 million representing the estimated fair value of the 3,002,778 common shares to be issued in the aggregate subject to court approval.

(iii) *Additional stock consideration*. The Company concluded that the contingent obligation to issue an additional one million shares of its common stock, as defined in the stipulation of settlement agreement, met the definition of a derivative instrument in accordance with ASC 815 *Derivatives and Hedging*. The Company estimated the fair value of the derivative instrument using the Monte Carlo simulation model to forecast the contingent obligation applying probabilities that the stock price will be lower than $1.00 based on the following assumptions: expected volatility of 60%, risk free interest rate of 0.16% and final judgment dates ranging from four to six months. As a result, the Company estimated the fair value of this contingent obligation to be immaterial.

Item 1A. Risk Factors

You should consider carefully the following information about the risks described below, together with the other information contained in this quarterly report on Form 10-Q before you decide to buy or maintain an investment in our common stock. We believe the risks described below are the risks that are material to us as of the date of this quarterly report. Additional risks and uncertainties that we are unaware of may also become important factors that affect us. The risk factors set forth below with an asterisk (*) next to the title contain changes to the description of the risk factors previously disclosed in Item 1A to our Annual Report on Form 10-K. If any of the following risks actually occur, our business, financial condition, results of operations and future growth prospects would likely be materially and adversely affected. In these circumstances, the market price of our common stock could decline, and you may lose all or part of the money you paid to buy our common stock.

RISKS RELATED TO OUR BUSINESS

We depend heavily on the successful development and commercialization of our lead product candidate, AFREZZA, which is not yet approved.

To date, we have not commercialized any product candidates. We have expended significant time, money and effort in the development of our lead product candidate, AFREZZA, which has not yet received regulatory approval and which may not be approved by the FDA in a timely manner, or at all. Our other product candidates are generally in early clinical or preclinical development. We anticipate that in the near term, our ability to generate revenues will depend solely on the successful development and commercialization of AFREZZA.

In January 2011, the FDA issued a Complete Response letter and requested that we conduct additional clinical studies of AFREZZA using our next-generation inhaler. In early May 2011, we held an End-of-Review meeting with the agency to discuss the protocols for the additional studies. In August 2011, we confirmed with the FDA the design of two clinical studies to evaluate the efficacy and safety of AFREZZA administered using our Dreamboat inhaler. We plan to continue working closely with the FDA in our effort to ensure that our clinical studies address the agency s requests for additional information about AFREZZA. There can be no assurance that we will satisfy all of the FDA s requirements. The FDA could also again request that we conduct additional clinical trials to provide sufficient data for approval of the NDA. There can be no assurance that we will obtain approval of the NDA in a timely manner or at all.

We must receive the necessary approvals from the FDA and similar foreign regulatory agencies before AFREZZA can be marketed and sold in the United States or elsewhere. Even if we were to receive regulatory approval, we ultimately may be unable to gain market acceptance of AFREZZA for a variety of reasons, including the treatment and dosage regimen, potential adverse effects, the availability of alternative treatments and cost effectiveness. If we fail to commercialize AFREZZA, our business, financial condition and results of operations will be materially and adversely affected.

We have sought to develop our product candidates through our internal research programs. All of our product candidates will require additional research and development and, in some cases, significant preclinical, clinical and other testing prior to seeking regulatory approval to market them. Accordingly, these product candidates will not be commercially available for a number of years, if at all.

A significant portion of the research that we have conducted involves new and unproven compounds and technologies, including AFREZZA, Technosphere platform technology and immunotherapy product candidates. Even if our research programs identify candidates that initially show promise, these candidates may fail to progress to clinical development for any number of reasons, including discovery upon further research that these candidates have adverse effects or other characteristics that indicate they are unlikely to be effective. In addition, the clinical results we obtain at one stage are not necessarily indicative of future testing results. If we fail to successfully complete the development and commercialization of AFREZZA or develop or expand our other product candidates, or are significantly delayed in doing so, our business and results of operations will be harmed and the value of our stock could decline.

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We have a history of operating losses, we expect to continue to incur losses and we may never generate positive cash flow from operations.*

We are a development stage company with no commercial products. All of our product candidates are still being developed, and all but AFREZZA are still in the early stages of development. Our product candidates will require significant additional development, clinical trials, regulatory clearances and additional investment before they can be commercialized. We cannot be certain when AFREZZA may be approved or if it will be approved.

We have never been profitable or generated positive cash flow from operations and, as of June 30, 2012, we had incurred a cumulative net loss of $2.0 billion. The cumulative net loss has resulted principally from costs incurred in our research and development programs, the write-off of goodwill and general operating expenses. We expect to make substantial expenditures and to incur increasing operating losses in the future in order to further develop and commercialize our product candidates, including costs and expenses to complete clinical trials, seek regulatory approvals and market our product candidates, including AFREZZA. This cumulative net loss may increase significantly as we continue development and clinical trial efforts.

Our losses have had, and are expected to continue to have, an adverse impact on our working capital, total assets and stockholders equity. As of June 30, 2012, we had a stockholders deficit of $244.4 million. Our ability to achieve and sustain positive cash flow from operations and profitability depends upon obtaining regulatory approvals for and successfully commercializing AFREZZA, either alone or with third parties. We do not currently have the required approvals to market any of our product candidates, and we may not receive them. We may not generate positive cash flow from operations or be profitable even if we succeed in commercializing any of our product candidates. As a result, we cannot be sure when we will generate positive cash flow from operations or become profitable, if at all.

We will be required to raise additional capital to fund our operations, and our inability to do so could raise substantial doubt about our ability to continue as a going concern.*

Based upon our current expectations, we believe that our existing capital resources, including the available borrowings under our loan arrangement with The Mann Group, as amended, will enable us to continue planned operations into the fourth quarter of 2012. However, we cannot assure you that our plans will not change or that changed circumstances will not result in the depletion of our capital resources more rapidly than we currently anticipate. We will need to raise additional funds, whether through the sale of equity or debt securities, the entry into strategic business collaborations, the establishment of other funding facilities, licensing arrangements, asset sales or other means, or an increase in the borrowings available under the loan arrangement with our related party, in order to continue the development and commercialization of AFREZZA and other product candidates and to support our other ongoing activities. However, it may be difficult for us to raise additional funds through these planned measures. As of June 30, 2012, we had a stockholders deficit of $244.4 million which may raise concerns about our solvency and affect our ability to raise additional capital. The amount of additional funds we need will depend on a number of factors, including:

- rate of progress and costs of our clinical trials and research and development activities, including costs of procuring clinical materials and operating our manufacturing facilities;
- our success in establishing strategic business collaborations or other sales or licensing of assets, and the timing and amount of any payments we might receive from any such transactions we are able to establish;
- actions taken by the FDA and other regulatory authorities affecting our products and competitive products;
- our degree of success in commercializing AFREZZA assuming receipt of required regulatory approvals;
- the emergence of competing technologies and products and other adverse market developments;

the costs of preparing, filing, prosecuting, maintaining and enforcing patent claims and other intellectual property rights or defending against claims of infringement by others;

the level of our legal expenses;

the costs of discontinuing projects and technologies; and

the costs of decommissioning existing facilities, if we undertake such activities.

We have raised capital in the past primarily through the sale of equity and debt securities. We may in the future pursue the sale of additional equity and/or debt securities, or the establishment of other funding facilities including asset based borrowings. There can be no assurances, however, that we will be able to raise additional capital through such an offering on acceptable terms, or at all.

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Issuances of additional debt or equity securities, or the conversion of any of our currently outstanding convertible debt securities into shares of our common stock or the exercise of our currently outstanding warrants for shares of our common stock could impact the rights of the holders of our common stock and may dilute their ownership percentage. Moreover, the establishment of other funding facilities may impose restrictions on our operations. These restrictions could include limitations on additional borrowing and specific restrictions on the use of our assets, as well as prohibitions on our ability to create liens, pay dividends, redeem our stock or make investments. We also may seek to raise additional capital by pursuing opportunities for the licensing or sale of certain intellectual property and other assets. We cannot offer assurances, however, that any strategic collaborations, sales of securities or sales or licenses of assets will be available to us on a timely basis or on acceptable terms, if at all. We may be required to enter into relationships with third parties to develop or commercialize products or technologies that we otherwise would have sought to develop independently, and any such relationships may not be on terms as commercially favorable to us as might otherwise be the case.

In the event that sufficient additional funds are not obtained through strategic collaboration opportunities, sales of securities, funding facilities, licensing arrangements and/or asset sales on a timely basis, we will be required to reduce expenses through the delay, reduction or curtailment of our projects, including AFREZZA development activities, or further reduction of costs for facilities and administration. Moreover, if we do not obtain such additional funds, there will be substantial doubt about our ability to continue as a going concern and increased risk of insolvency and loss of investment to the holders of our securities. As of the date hereof, we have not obtained a solvency opinion or otherwise conducted a valuation of our properties to determine whether our debts exceed the fair value of our property within the meaning of applicable solvency laws. If we are or become insolvent, investors in our stock may lose the entire value of their investment.

Because we will not be able to generate operating cash flow before AFREZZA is commercialized, which we expect will require us to reach an agreement with a commercialization partner, we cannot provide assurances that changed or unexpected circumstances, including, among other things, delays in obtaining regulatory approval and in identifying and reaching agreements with a commercialization partner, will not result in the depletion of our capital resources more rapidly than we currently anticipate, in which case we may be required to raise additional capital. There can be no assurances that we will be able to raise additional capital on acceptable terms, or at all. If planned operating results are not achieved or we are not successful in raising additional capital through equity or debt financings or entering into a strategic business collaboration with a pharmaceutical or biotechnology company, we will be required to reduce expenses through the delay, reduction or curtailment of our projects, including AFREZZA development activities, or further reduction of costs for facilities and administration, and there will be continued substantial doubt about our ability to continue as a going concern.

Deteriorating global economic conditions may have an adverse impact on our loan facility with The Mann Group.

As widely reported, financial markets in the United States, Europe and Asia have experienced a period of unprecedented turmoil and upheaval characterized by extreme volatility and declines in security prices, severely diminished liquidity and credit availability, inability to access capital markets, the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the United States federal government and other governments. We cannot predict the impact of these events on our loan facility with The Mann Group. If we are unable to draw on The Mann Group loan facility, our business and financial condition may be adversely affected.

If we do not achieve our projected development and commercialization goals in the timeframes we announce and expect, our business would be harmed and the market price of our common stock could decline.

For planning purposes, we estimate the timing of the accomplishment of various scientific, clinical, regulatory and other product development goals, which we sometimes refer to as milestones. These milestones may include the commencement or completion of scientific studies and clinical trials and the submission of regulatory filings. From time to time, we publicly announce the expected timing of some of these milestones. All of these milestones are based on a variety of assumptions. The actual timing of the achievement of these milestones can vary dramatically from our estimates, in many cases for reasons beyond our control, depending on numerous factors, including:

- the rate of progress, costs and results of our clinical trial and research and development activities, which will be impacted by the level of proficiency and experience of our clinical staff;

- our ability to identify and enroll patients who meet clinical trial eligibility criteria;

our ability to access sufficient, reliable and affordable supplies of components used in the manufacture of our product candidates, including insulin and other materials for AFREZZA;

the costs of expanding and maintaining manufacturing operations, as necessary;

the extent of scheduling conflicts with participating clinicians and clinical institutions;

the receipt of approvals by our competitors and by us from the FDA and other regulatory agencies;

our ability to enter into sales and marketing collaborations for AFREZZA; and

other actions by regulators.

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In addition, if we do not obtain sufficient additional funds through sales of securities, strategic collaborations or the license or sale of certain of our assets on a timely basis, we will be required to reduce expenses by delaying, reducing or curtailing our development of AFREZZA. If we fail to commence or complete, or experience delays in or are forced to curtail, our proposed clinical programs or otherwise fail to adhere to our projected development goals in the timeframes we announce and expect (or within the timeframes expected by analysts or investors), our business and results of operations will be harmed and the market price of our common stock will decline.

We face substantial competition in the development of our product candidates and may not be able to compete successfully, and our product candidates may be rendered obsolete by rapid technological change.

A number of established pharmaceutical companies have or are developing technologies for the treatment of diabetes. We also face substantial competition for the development of our other product candidates.

Many of our existing or potential competitors have, or have access to, substantially greater financial, research and development, production, and sales and marketing resources than we do and have a greater depth and number of experienced managers. As a result, our competitors may be better equipped than we are to develop, manufacture, market and sell competing products. In addition, gaining favorable reimbursement is critical to the success of AFREZZA. Many of our competitors have existing infrastructure and relationships with managed care organizations and reimbursement authorities which can be used to their advantage.

The rapid rate of scientific discoveries and technological changes could result in one or more of our product candidates becoming obsolete or noncompetitive. Our competitors may develop or introduce new products that render our technology and AFREZZA less competitive, uneconomical or obsolete. Our future success will depend not only on our ability to develop our product candidates but to improve them and keep pace with emerging industry developments. We cannot assure you that we will be able to do so.

We also expect to face increasing competition from universities and other non-profit research organizations. These institutions carry out a significant amount of research and development in the areas of diabetes and cancer. These institutions are becoming increasingly aware of the commercial value of their findings and are more active in seeking patent and other proprietary rights as well as licensing revenues.

If we fail to enter into a strategic collaboration with respect to AFREZZA, we may not be able to execute on our business model.

We have held extensive discussions with a number of pharmaceutical companies concerning a potential strategic business collaboration for AFREZZA. To date we have not reached an agreement on a collaboration with any of these companies. We cannot predict when, if ever, we could conclude an agreement with a partner. There can be no assurance that any such collaboration will be available to us on a timely basis or on acceptable terms. If we are not able to enter into a collaboration on terms that are favorable to us, we may be unable to undertake and fund product development, clinical trials, manufacturing and/or marketing activities at our own expense, which would delay or otherwise impede the commercialization of AFREZZA. We will face similar challenges as we seek to develop our other product candidates. Our current strategy for developing, manufacturing and commercializing our other product candidates includes evaluating the potential for collaborating with pharmaceutical and biotechnology companies at some point in the drug development process and for these collaborators to undertake the advanced clinical development and commercialization of our product candidates. It may be difficult for us to find third parties that are willing to enter into collaborations on economic terms that are favorable to us, or at all. Failure to enter into a collaboration with respect to any other product candidate could substantially increase our requirements for capital and force us to substantially reduce our development effort.

If we enter into collaborative agreements with respect to AFREZZA and if our third-party collaborators do not perform satisfactorily or if our collaborations fail, development or commercialization of AFREZZA may be delayed and our business could be harmed.

We may enter into license agreements, partnerships or other collaborative arrangements to support the financing, development and marketing of AFREZZA. We may also license technology from others to enhance or supplement our technologies. These various collaborators may enter into arrangements that would make them potential competitors. These various collaborators also may breach their agreements with us and delay our progress or fail to perform under their agreements, which could harm our business.

If we enter into collaborative arrangements, we will have less control over the timing, planning and other aspects of our clinical trials, and the sale and marketing of AFREZZA and our other product candidates. We cannot offer assurances that we will be able to enter into satisfactory arrangements with third parties as contemplated or that any of our existing or future collaborations will be successful.

Continued testing of AFREZZA or our other product candidates may not yield successful results, and even if it does, we may still be unable to commercialize our product candidates.

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Our research and development programs are designed to test the safety and efficacy of AFREZZA and our other product candidates through extensive nonclinical and clinical testing. We may experience numerous unforeseen events during, or as a result of, the testing process that could delay or prevent commercialization of AFREZZA or any of our other product candidates, including the following:

- safety and efficacy results for AFREZZA obtained in our nonclinical and previous clinical testing may be inconclusive or may not be predictive of results that we may obtain in our future clinical trials or following long-term use, and we may as a result be forced to stop developing AFREZZA;
- the data collected from clinical trials of AFREZZA or our other product candidates may not reach statistical significance or otherwise be sufficient to support FDA or other regulatory approval;
- after reviewing test results, we or any potential collaborators may abandon projects that we previously believed were promising; and
- our product candidates may not produce the desired effects or may result in adverse health effects or other characteristics that preclude regulatory approval or limit their commercial use if approved.

Forecasts about the effects of the use of drugs, including AFREZZA, over terms longer than the clinical trials or in much larger populations may not be consistent with the clinical results. If use of AFREZZA results in adverse health effects or reduced efficacy or both, the FDA or other regulatory agencies may terminate our ability to market and sell AFREZZA, may narrow the approved indications for use or otherwise require restrictive product labeling or marketing, or may require further clinical trials, which may be time-consuming and expensive and may not produce favorable results.

As a result of any of these events, we, any collaborator, the FDA, or any other regulatory authorities, may suspend or terminate clinical trials or marketing of AFREZZA at any time. Any suspension or termination of our clinical trials or marketing activities may harm our business and results of operations and the market price of our common stock may decline.

If our suppliers fail to deliver materials and services needed for the production of AFREZZA in a timely and sufficient manner, or they fail to comply with applicable regulations, our business and results of operations would be harmed and the market price of our common stock could decline.

For AFREZZA to be commercially viable, we need access to sufficient, reliable and affordable supplies of insulin, our AFREZZA inhaler, the related cartridges and other materials. We must rely on our suppliers to comply with relevant regulatory and other legal requirements, including the production of insulin in accordance with the FDA s current good manufacturing practices, or cGMP for drug products, and the production of the AFREZZA inhaler and related cartridges in accordance with Quality System Regulations, or QSR. The supply of any of these materials may be limited or any of the manufacturers may not meet relevant regulatory requirements, and if we are unable to obtain any of these materials in sufficient amounts, in a timely manner and at reasonable prices, or if we should encounter delays or difficulties in our relationships with manufacturers or suppliers, the development or manufacturing of AFREZZA may be delayed. Any such events could delay market introduction and subsequent sales of AFREZZA and, if so, our business and results of operations will be harmed and the market price of our common stock may decline.

We have never manufactured AFREZZA or any other product candidates in commercial quantities, and if we fail to develop an effective manufacturing capability for our product candidates or to engage third-party manufacturers with this capability, we may be unable to commercialize these products.

We use our Danbury, Connecticut facility to formulate AFREZZA inhalation powder, fill plastic cartridges with the powder, package the cartridges in blister packs, place the two blister packs into foil pouches and package three pouches plus two inhalers and the package insert as units in 90-unit boxes (and single blister pouch packs for trials). Although this facility has been qualified and undergone an inspection by the FDA in connection with our original NDA submission that sought approval of AFREZZA using our MedTone inhaler, we anticipate that our facility will need to undergo further inspection related to our ability to fill and package cartridges for the next-generation Dreamboat inhaler before we can be approved to distribute the manufactured products commercially. The manufacture of pharmaceutical products requires significant expertise and capital investment, including the development of advanced manufacturing techniques and process controls.

Manufacturers of pharmaceutical products often encounter difficulties in production, especially in scaling up initial production. These problems include difficulties with production costs and yields, quality control and assurance and shortages of qualified personnel, as well as compliance with strictly enforced federal, state and foreign regulations. If we engage a third-party manufacturer, we would need to transfer our technology to that third-party manufacturer and gain FDA approval, potentially causing delays in product delivery. In addition, our third-party manufacturer may not perform as agreed or may terminate its agreement with us.

Any of these factors could cause us to delay or suspend clinical trials, regulatory submissions or required approvals of our product candidates, could entail higher costs and may result in our being unable to effectively commercialize our products. Furthermore, if we or a third-party manufacturer fail to deliver the required commercial quantities of any product on a timely basis, and at commercially reasonable prices and acceptable quality, and we were unable to promptly find one or more replacement manufacturers capable of production at a substantially equivalent cost, in substantially equivalent volume and quality on a timely basis, we would likely be unable to meet demand for such products and we would lose potential revenues.

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Our operations might be interrupted by the occurrence of a natural disaster or other catastrophic event.

We expect that at least for the foreseeable future, our manufacturing facility in Danbury, Connecticut will be the sole location for the manufacturing of AFREZZA. This facility and the manufacturing equipment we use would be costly to replace and could require substantial lead time to repair or replace. We depend on our facilities and on collaborators, contractors and vendors for the continued operation of our business, some of whom are located in Europe. Natural disasters or other catastrophic events, including interruptions in the supply of natural resources, political and governmental changes, severe weather conditions, wildfires and other fires, explosions, actions of animal rights activists, terrorist attacks, volcanic eruptions, earthquakes and wars could disrupt our operations or those of our collaborators, contractors and vendors. We might suffer losses as a result of business interruptions that exceed the coverage available under our and our contractors insurance policies or for which we or our contractors do not have coverage. For example, we are not insured against a terrorist attack. Any natural disaster or catastrophic event could have a significant negative impact on our operations and financial results. Moreover, any such event could delay our research and development programs and adversely affect, which may include stopping, our readiness for commercial production.

We deal with hazardous materials and must comply with environmental laws and regulations, which can be expensive and restrict how we do business.

Our research and development work involves the controlled storage and use of hazardous materials, including chemical and biological materials. In addition, our manufacturing operations involve the use of a chemical that may form an explosive mixture under certain conditions. Our operations also produce hazardous waste products. We are subject to federal, state and local laws and regulations (i) governing how we use, manufacture, store, handle and dispose of these materials (ii) imposing liability for costs of cleaning up, and damages to natural resources from past spills, waste disposals on and off-site, or other releases of hazardous materials or regulated substances, and (iii) regulating workplace safety. Moreover, the risk of accidental contamination or injury from hazardous materials cannot be completely eliminated, and in the event of an accident, we could be held liable for any damages that may result, and any liability could fall outside the coverage or exceed the limits of our insurance. Currently, our general liability policy provides coverage up to $1.0 million per occurrence and $2.0 million in the aggregate and is supplemented by an umbrella policy that provides a further $4.0 million of coverage; however, our insurance policy excludes pollution liability coverage and we do not carry a separate hazardous materials policy. In addition, we could be required to incur significant costs to comply with environmental laws and regulations in the future. Finally, current or future environmental laws and regulations may impair our research, development or production efforts or have an adverse impact on our business, results of operations and financial condition.

When we purchased the facilities located in Danbury, Connecticut in 2001, there was a soil and groundwater investigation and remediation being conducted by a former site operator (the responsible party) under the oversight of the Connecticut Department of Environmental Protection, or CT DEP, which is continuing. As part of the purchase, we obtained an indemnification from the seller for all known environmental conditions that existed at the time the seller acquired the property. The seller was, in turn, indemnified for these known environmental conditions by the previous owner and its operator (responsible party). We also received an indemnification from the seller for environmental conditions created during its ownership of the property and for environmental problems unknown at the time that the seller acquired the property. These additional indemnities have since expired and were limited to the purchase price we paid for the Danbury facilities.

During the construction of our expanded manufacturing facility, we excavated contaminated soil under the footprint of our building expansion location, at a cost of approximately $2.25 million. The responsible party reimbursed us for our increased excavation and disposal costs of contaminated soil in the amount of $1.625 million in July 2010. The responsible party has further agreed to conduct at its expense all work and make all filings necessary to achieve closure for the environmental investigation and remediation being conducted at the site and agreed to pay for or indemnify us for any future costs and expenses we may incur that are directly related to the final closure of the environmental remediation. If we are unable to collect these future costs and expenses, if any, from the responsible party, our business and results of operations may be harmed.

If we fail to enter into collaborations with third parties, we would be required to establish our own sales, marketing and distribution capabilities, which could impact the commercialization of our products and harm our business.

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Our product candidates are intended to be used by a large number of healthcare professionals who will require substantial education and support. For example, a broad base of physicians, including primary care physicians and endocrinologists, treat patients with diabetes. A large sales force will be required in order to educate these physicians about the benefits and advantages of AFREZZA and to provide adequate support for them. Therefore, our primary strategy is to enter into collaborations with one or more pharmaceutical companies to market, distribute and sell AFREZZA, if it is approved. If we fail to enter into collaborations, we would be required to establish our own direct sales, marketing and distribution capabilities. Establishing these capabilities can be time-consuming and expensive and would delay our ability to commercialize AFREZZA. Because we lack experience in selling pharmaceutical products to the diabetes market, we would be at a disadvantage compared to our potential competitors, all of whom have substantially more resources and experience than we do. For example, several other companies selling products to treat diabetes have existing sales forces in excess of 1,500 sales representatives. We, acting alone, would not initially be able to field a sales force as large as our competitors or provide the same degree of marketing support. Also, we would not be able to match our competitors spending levels for pre-launch marketing preparation, including medical education. We cannot assure you that we will succeed in entering into acceptable collaborations, that any such collaboration will be successful or, if not, that we will successfully develop our own sales, marketing and distribution capabilities.

If any product that we may develop does not become widely accepted by physicians, patients, third-party payers and the healthcare community, we may be unable to generate significant revenue, if any.

AFREZZA and our other product candidates are new and unproven. Even if any of our product candidates obtain regulatory approval, they may not gain market acceptance among physicians, patients, third-party payers and the healthcare community. Failure to achieve market acceptance would limit our ability to generate revenue and would adversely affect our results of operations.

The degree of market acceptance of AFREZZA and our other product candidates will depend on many factors, including the:

- claims for which FDA approval can be obtained, including superiority claims;
- perceived advantages and disadvantages of competitive products;
- willingness of the healthcare community and patients to adopt new technologies;
- ability to manufacture the product in sufficient quantities with acceptable quality and cost;
- perception of patients and the healthcare community, including third-party payers, regarding the safety, efficacy and benefits compared to competing products or therapies;
- convenience and ease of administration relative to existing treatment methods;
- pricing and reimbursement relative to other treatment therapeutics and methods; and
- marketing and distribution support.

Because of these and other factors, any product that we may develop may not gain market acceptance, which would materially harm our business, financial condition and results of operations.

If third-party payers do not reimburse consumers for our products, our products might not be used or purchased, which would adversely affect our revenues.

Our future revenues and ability to generate positive cash flow from operations may be affected by the continuing efforts of governments and third-party payers to contain or reduce the costs of healthcare through various means. For example, in certain foreign markets the pricing of prescription pharmaceuticals is subject to governmental control. In the United States, there has been, and we expect that there will continue to be, a number of federal and state proposals to implement similar governmental controls. We cannot be certain what legislative proposals will be adopted or what actions federal, state or private payers for healthcare goods and services may take in response to any drug pricing reform proposals or legislation. Such reforms may make it difficult to complete the development and testing of AFREZZA and our other product candidates, and therefore may limit our ability to generate revenues from sales of our product candidates and achieve profitability. Further, to the extent that such reforms have a material adverse effect on the business, financial condition and profitability of other companies that are prospective collaborators for some of our product candidates, our ability to commercialize our product candidates under development may be adversely affected.

In the United States and elsewhere, sales of prescription pharmaceuticals still depend in large part on the availability of reimbursement to the consumer from third-party payers, such as governmental and private insurance plans. Third-party payers are increasingly challenging the prices charged for medical products and services. In addition, because each third-party payer individually approves reimbursement, obtaining these approvals is a time-consuming and costly process. We would be required to provide scientific and clinical support for the use of any product to each third-party payer separately with no assurance that approval would be obtained. This process could delay the market acceptance of any product and could have a negative effect on our future revenues and operating results. Even if we succeed in bringing one or more products to market, we cannot be certain that any such products would be considered cost-effective or that reimbursement to the consumer would be available, in which case our business and results of operations would be harmed and the market price of our common stock could decline.

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If product liability claims are brought against us, we may incur significant liabilities and suffer damage to our reputation.

The testing, manufacturing, marketing and sale of AFREZZA and our other product candidates expose us to potential product liability claims. A product liability claim may result in substantial judgments as well as consume significant financial and management resources and result in adverse publicity, decreased demand for a product, injury to our reputation, withdrawal of clinical trial volunteers and loss of revenues. We currently carry worldwide liability insurance in the amount of $10.0 million. In addition, we carry local policies per trial in each country in which we conduct clinical trials that require us to carry coverage based on local statutory requirements. We intend to obtain product liability coverage for commercial sales in the future if AFREZZA is approved. However, we may not be able to obtain insurance coverage that will be adequate to satisfy any liability that may arise, and because insurance coverage in our industry can be very expensive and difficult to obtain, we cannot assure you that we will be able to obtain sufficient coverage at an acceptable cost, if at all. If losses from such claims exceed our liability insurance coverage, we may ourselves incur substantial liabilities. If we are required to pay a product liability claim our business and results of operations would be harmed and the market price of our common stock may decline.

If we lose any key employees or scientific advisors, our operations and our ability to execute our business strategy could be materially harmed.

In order to commercialize our product candidates successfully, we will be required to expand our work force, particularly in the areas of manufacturing and sales and marketing. These activities will require the addition of new personnel, including management, and the development of additional expertise by existing personnel. We face intense competition for qualified employees among companies in the biotechnology and biopharmaceutical industries. Our success depends upon our ability to attract, retain and motivate highly skilled employees. We may be unable to attract and retain these individuals on acceptable terms, if at all.

The loss of the services of any principal member of our management and scientific staff could significantly delay or prevent the achievement of our scientific and business objectives. All of our employees are at will and we currently do not have employment agreements with any of the principal members of our management or scientific staff, and we do not have key person life insurance to cover the loss of any of these individuals. Replacing key employees may be difficult and time-consuming because of the limited number of individuals in our industry with the skills and experience required to develop, gain regulatory approval of and commercialize our product candidates successfully.

We have relationships with scientific advisors at academic and other institutions to conduct research or assist us in formulating our research, development or clinical strategy. These scientific advisors are not our employees and may have commitments to, and other obligations with, other entities that may limit their availability to us. We have limited control over the activities of these scientific advisors and can generally expect these individuals to devote only limited time to our activities. Failure of any of these persons to devote sufficient time and resources to our programs could harm our business. In addition, these advisors are not prohibited from, and may have arrangements with, other companies to assist those companies in developing technologies that may compete with our product candidates.

If our Chairman and Chief Executive Officer is unable to devote sufficient time and attention to our business, our operations and our ability to execute our business strategy could be materially harmed.

Alfred Mann, our Chairman and Chief Executive Officer, is involved in many other business and charitable activities. As a result, the time and attention Mr. Mann devotes to the operation of our business varies, and he may not expend the same time or focus on our activities as other, similarly situated chief executive officers. If Mr. Mann is unable to devote the time and attention necessary to running our business, we may not be able to execute our business strategy and our business could be materially harmed.

If our internal controls over financial reporting are not considered effective, our business and stock price could be adversely affected.

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to evaluate the effectiveness of our internal controls over financial reporting as of the end of each fiscal year, and to include a management report assessing the effectiveness of our internal controls over financial reporting in our annual report on Form 10-K for that fiscal year. Section 404 also requires our independent registered public accounting firm to attest to, and report on, our internal controls over financial reporting.

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our internal controls over financial reporting will prevent all errors 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 involving a company have been, or will be, detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and we

cannot assure you 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

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system, misstatements due to error or fraud may occur and not be detected. We cannot assure you that we or our independent registered public accounting firm will not identify a material weakness in our internal controls in the future. A material weakness in our internal controls over financial reporting would require management and our independent registered public accounting firm to evaluate our internal controls as ineffective. If our internal controls over financial reporting are not considered effective, we may experience a loss of public confidence, which could have an adverse effect on our business and on the market price of our common stock.

RISKS RELATED TO REGULATORY APPROVALS

Our product candidates must undergo rigorous nonclinical and clinical testing and we must obtain regulatory approvals, which could be costly and time-consuming and subject us to unanticipated delays or prevent us from marketing any products.

Our research and development activities, as well as the manufacturing and marketing of our product candidates, including AFREZZA, are subject to regulation, including regulation for safety, efficacy and quality, by the FDA in the United States and comparable authorities in other countries. FDA regulations and the regulations of comparable foreign regulatory authorities are wide-ranging and govern, among other things:

product design, development, manufacture and testing;

product labeling;

product storage and shipping;

pre-market clearance or approval;

advertising and promotion; and

product sales and distribution.

Clinical testing can be costly and take many years, and the outcome is uncertain and susceptible to varying interpretations. We cannot be certain if or when the FDA might request additional studies, under what conditions such studies might be requested, or what the size or length of any such studies might be. The clinical trials of our product candidates may not be completed on schedule, the FDA or foreign regulatory agencies may order us to stop or modify our research, or these agencies may not ultimately approve any of our product candidates for commercial sale. The data collected from our clinical trials may not be sufficient to support regulatory approval of our various product candidates, including AFREZZA. Even if we believe the data collected from our clinical trials are sufficient, the FDA has substantial discretion in the approval process and may disagree with our interpretation of the data. Our failure to adequately demonstrate the safety and efficacy of any of our product candidates would delay or prevent regulatory approval of our product candidates, which could prevent us from achieving profitability.

The requirements governing the conduct of clinical trials and manufacturing and marketing of our product candidates, including AFREZZA, outside the United States vary widely from country to country. Foreign approvals may take longer to obtain than FDA approvals and can require, among other things, additional testing and different clinical trial designs. Foreign regulatory approval processes include essentially all of the risks associated with the FDA approval processes. Some of those agencies also must approve prices of the products. Approval of a product by the FDA does not ensure approval of the same product by the health authorities of other countries. In addition, changes in regulatory policy in the United States or in foreign countries for product approval during the period of product development and regulatory agency review of each submitted new application may cause delays or rejections.

The process of obtaining FDA and other required regulatory approvals, including foreign approvals, is expensive, often takes many years and can vary substantially based upon the type, complexity and novelty of the products involved. We are not aware of any precedent for the successful commercialization of products based on our technology. In January 2006, the FDA approved the first pulmonary insulin product, Exubera. This approval has had an impact on, and notwithstanding the voluntary withdrawal of the product from the market by its manufacturer

could still impact, the development and registration of AFREZZA in different ways. For example, Exubera may be used as a reference for safety and efficacy evaluations of AFREZZA, and the approval standards set for Exubera may be applied to other products that follow, including AFREZZA.

The FDA is regulating AFREZZA as a combination product because of the complex nature of the system that includes the combination of a new drug (AFREZZA) and a new medical device (the inhaler used to administer the insulin). The review of our NDA for AFREZZA involves several separate review groups of the FDA including: (1) the Metabolic and Endocrine Drug Products Division; (2) the Pulmonary Drug Products Division; and (3) the Center for Devices and Radiological Health, which reviews medical devices. The Metabolic and Endocrine Drug Products Division is the lead group and obtains consulting reviews from the other two FDA groups. We can make no assurances at this time about what impact FDA review by multiple groups will have on the approvability of our product or that we will obtain approval of the NDA in a timely manner or at all.

Also, questions that have been raised about the safety of marketed drugs generally, including pertaining to the lack of adequate labeling, may result in increased cautiousness by the FDA in reviewing new drugs based on safety, efficacy, or other regulatory considerations and may result in significant delays in obtaining regulatory approvals. Such regulatory considerations may also result in

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the imposition of more restrictive drug labeling or marketing requirements as conditions of approval, which may significantly affect the marketability of our drug products. FDA review of AFREZZA as a combination product may lengthen the product development and regulatory approval process, increase our development costs and delay or prevent the commercialization of AFREZZA. Other product candidates that we may develop could face similar obstacles and costs.

We have only limited experience in filing and pursuing applications necessary to gain regulatory approvals, which may impede our ability to obtain timely approvals from the FDA or foreign regulatory agencies, if at all.

We will not be able to commercialize AFREZZA or any other product candidates unless we have obtained regulatory approval. Until we prepared and submitted our NDA for AFREZZA, we had no experience as a company in late-stage regulatory filings, such as preparing and submitting NDAs, which may place us at risk of delays, overspending and human resources inefficiencies. Any delay in obtaining, or inability to obtain, regulatory approval could harm our business.

If we do not comply with regulatory requirements at any stage, whether before or after marketing approval is obtained, we may be subject to criminal prosecution, fined or forced to remove a product from the market or experience other adverse consequences, including restrictions or delays in obtaining regulatory marketing approval.

Even if we comply with regulatory requirements, we may not be able to obtain the labeling claims necessary or desirable for product promotion. We may also be required to undertake post-marketing trials. In addition, if we or other parties identify adverse effects after any of our products are on the market, or if manufacturing problems occur, regulatory approval may be withdrawn and a reformulation of our products, additional clinical trials, changes in labeling of, or indications of use for, our products and/or additional marketing applications may be required. If we encounter any of the foregoing problems, our business and results of operations will be harmed and the market price of our common stock may decline.

Even if we obtain regulatory approval for our product candidates, such approval may be limited and we will be subject to stringent, ongoing government regulation.

Even if regulatory authorities approve any of our product candidates, they could approve less than the full scope of uses or labeling that we seek or otherwise require special warnings or other restrictions on use or marketing or could require potentially costly post-marketing follow-up clinical trials. Regulatory authorities may limit the segments of the diabetes population to which we or others may market AFREZZA or limit the target population for our other product candidates. There are no assurances that any advantages of AFREZZA will be agreed to by the FDA or otherwise included in product labeling or advertising and, as a result, AFREZZA may not have our expected competitive advantages when compared to other insulin products.

The manufacture, marketing and sale of any of our product candidates will be subject to stringent and ongoing government regulation. The FDA may also withdraw product approvals if problems concerning the safety or efficacy of a product appear following approval. We cannot be sure that FDA and United States Congressional initiatives or actions by foreign regulatory bodies pertaining to ensuring the safety of marketed drugs or other developments pertaining to the pharmaceutical industry will not adversely affect our operations.

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We also are required to register our establishments and list our products with the FDA and certain state agencies. We and any third-party manufacturers or suppliers must continually adhere to federal regulations setting forth requirements, known as cGMP (for drugs) and QSR (for medical devices), and their foreign equivalents, which are enforced by the FDA and other national regulatory bodies through their facilities inspection programs. If our facilities, or the facilities of our manufacturers or suppliers, cannot pass a preapproval plant inspection, the FDA will not approve the marketing of our product candidates. In complying with cGMP and foreign regulatory requirements, we and any of our potential third-party manufacturers or suppliers will be obligated to expend time, money and effort in production, record-keeping and quality control to ensure that our products meet applicable specifications and other requirements. QSR requirements also impose extensive testing, control and documentation requirements. State regulatory agencies and the regulatory agencies of other countries have similar requirements. In addition, we will be required to comply with regulatory requirements of the FDA, state regulatory agencies and the regulatory agencies of other countries concerning the reporting of adverse events and device malfunctions, corrections and removals (*e.g.*, recalls), promotion and advertising and general prohibitions against the manufacture and distribution of adulterated and misbranded devices. Failure to comply with these regulatory requirements could result in civil fines, product seizures, injunctions and/or criminal prosecution of responsible individuals and us. Any such actions would have a material adverse effect on our business and results of operations.

Our suppliers will be subject to FDA inspection before the agency approves an NDA for AFREZZA.

When we are required to find a new or additional supplier of insulin, we will be required to evaluate the new supplier s ability to provide insulin that meets regulatory requirements, including cGMP requirements as well as our specifications and quality requirements, which would require significant time and expense and could delay the manufacturing and future commercialization of AFREZZA. We also depend on suppliers for other materials that comprise AFREZZA, including our AFREZZA inhaler and cartridges. Each supplier must comply with relevant regulatory requirements including QSR, and is subject to inspection by the FDA. There can be no assurance, in the conduct of an inspection of any of our suppliers, that the agency would find that the supplier substantially complies with the QSR or cGMP requirements, where applicable. If we or any potential third-party manufacturer or supplier fails to comply with these requirements or comparable requirements in foreign countries, regulatory authorities may subject us to regulatory action, including criminal prosecutions, fines and suspension of the manufacture of our products.

Reports of side effects or safety concerns in related technology fields or in other companies clinical trials could delay or prevent us from obtaining regulatory approval or negatively impact public perception of our product candidates.

At present, there are a number of clinical trials being conducted by us and other pharmaceutical companies involving insulin delivery systems. If we discover that AFREZZA is associated with a significantly increased frequency of adverse events, or if other pharmaceutical companies announce that they observed frequent adverse events in their trials involving insulin therapies, we could encounter delays in the timing of our clinical trials, difficulties in obtaining approval of AFREZZA or be subject to class warnings in the label for AFREZZA, if approved. As well, the public perception of AFREZZA might be adversely affected, which could harm our business and results of operations and cause the market price of our common stock to decline, even if the concern relates to another company s products or product candidates.

There are also a number of clinical trials being conducted by other pharmaceutical companies involving compounds similar to, or competitive with, our other product candidates. Adverse results reported by these other companies in their clinical trials could delay or prevent us from obtaining regulatory approval or negatively impact public perception of our product candidates, which could harm our business and results of operations and cause the market price of our common stock to decline.

RISKS RELATED TO INTELLECTUAL PROPERTY

If we are unable to protect our proprietary rights, we may not be able to compete effectively, or operate profitably.*

Our commercial success depends, in large part, on our ability to obtain and maintain intellectual property protection for our technology. Our ability to do so will depend on, among other things, complex legal and factual questions, and it should be noted that the standards regarding intellectual property rights in our fields are still evolving. We attempt to protect our proprietary technology through a combination of patents, trade secrets and confidentiality agreements. We own a number of domestic and international patents, have a number of domestic and international patent applications pending and have licenses to additional patents. We cannot assure you that our patents and licenses will successfully preclude others from using our technologies, and we could incur substantial costs in seeking enforcement of our proprietary rights against infringement. Even if issued, the patents may not give us an advantage over competitors with alternative technologies.

Moreover, the term of a patent is limited and, as a result, the patents protecting our products expire at various dates. For example, although some patents providing protection for our AFREZZA inhalation powder expired in 2012, other patents providing similar protection will remain in force into 2031. In addition, patents providing protection for our inhaler and cartridges will remain in force into 2023, and we have method of

treatment claims that can be maintained in force variously until 2029. As and when these different patents expire, AFREZZA could become subject to increased competition. As a consequence, we may not be able to recover our development costs.

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Moreover, the issuance of a patent is not conclusive as to its validity or enforceability and it is uncertain how much protection, if any, will be afforded by our patents. A third party may challenge the validity or enforceability of a patent after its issuance by various proceedings such as oppositions in foreign jurisdictions or re-examinations in the United States. If we attempt to enforce our patents, they may be challenged in court where they could be held invalid, unenforceable, or have their breadth narrowed to an extent that would destroy their value.

On September 16, 2011, the Leahy-Smith America Invents Act, or the Leahy-Smith Act, was signed into law. The Leahy-Smith Act includes a number of significant changes to United States patent law. These include provisions that affect the way patent applications will be prosecuted and may also affect patent litigation. The USPTO is currently developing regulations and procedures to govern administration of the Leahy-Smith Act, and many of the substantive changes to patent law associated with the Leahy-Smith Act will not become effective until one year or 18 months after its enactment. Accordingly, it is not clear what, if any, impact the Leahy-Smith Act will have on the operation of our business. However, the Leahy-Smith Act and its implementation could increase the uncertainties and costs surrounding the prosecution of our patent applications and the enforcement or defense of our issued patents, all of which could have a material adverse effect on our business and financial condition.

We also rely on unpatented technology, trade secrets, know-how and confidentiality agreements. We require our officers, employees, consultants and advisors to execute proprietary information and invention and assignment agreements upon commencement of their relationships with us. We also execute confidentiality agreements with outside collaborators. There can be no assurance, however, that these agreements will provide meaningful protection for our inventions, trade secrets, know-how or other proprietary information in the event of unauthorized use or disclosure of such information. If any trade secret, know-how or other technology not protected by a patent were to be disclosed to or independently developed by a competitor, our business, results of operations and financial condition could be adversely affected.

If we become involved in lawsuits to protect or enforce our patents or the patents of our collaborators or licensors, we would be required to devote substantial time and resources to prosecute or defend such proceedings.

Competitors may infringe our patents or the patents of our collaborators or licensors. To counter infringement or unauthorized use, we may be required to file infringement claims, which can be expensive and time-consuming. In addition, in an infringement proceeding, a court may decide that a patent of ours is not valid or is unenforceable, or may refuse to stop the other party from using the technology at issue on the grounds that our patents do not cover its technology. A court may also decide to award us a royalty from an infringing party instead of issuing an injunction against the infringing activity. An adverse determination of any litigation or defense proceedings could put one or more of our patents at risk of being invalidated or interpreted narrowly and could put our patent applications at risk of not issuing.

Interference proceedings brought by the United States Patent and Trademark Office, or USPTO, may be necessary to determine the priority of inventions with respect to our patent applications or those of our collaborators or licensors. Litigation or interference proceedings may fail and, even if successful, may result in substantial costs and be a distraction to our management. We may not be able, alone or with our collaborators and licensors, to prevent misappropriation of our proprietary rights, particularly in countries where the laws may not protect such rights as fully as in the United States. We may not prevail in any litigation or interference proceeding in which we are involved. Even if we do prevail, these proceedings can be very expensive and distract our management.

Furthermore, because of the substantial amount of discovery required in connection with intellectual property litigation, there is a risk that some of our confidential information could be compromised by disclosure during this type of litigation. In addition, during the course of this kind of litigation, there could be public announcements of the results of hearings, motions or other interim proceedings or developments. If securities analysts or investors perceive these results to be negative, the market price of our common stock may decline.

If our technologies conflict with the proprietary rights of others, we may incur substantial costs as a result of litigation or other proceedings and we could face substantial monetary damages and be precluded from commercializing our products, which would materially harm our business.

Over the past three decades the number of patents issued to biotechnology companies has expanded dramatically. As a result it is not always clear to industry participants, including us, which patents cover the multitude of biotechnology product types. Ultimately, the courts must determine the scope of coverage afforded by a patent and the courts do not always arrive at uniform conclusions.

A patent owner may claim that we are making, using, selling or offering for sale an invention covered by the owner s patents and may go to court to stop us from engaging in such activities. Such litigation is not uncommon in our industry.

Patent lawsuits can be expensive and would consume time and other resources. There is a risk that a court would decide that we are infringing a third party s patents and would order us to stop the activities covered by the patents, including the commercialization of our products. In addition,

there is a risk that we would have to pay the other party damages for having violated the other party s patents (which damages may be increased, as well as attorneys fees ordered paid, if infringement is found to be willful), or that we will be required to obtain a license from the other party in order to continue to commercialize the affected products, or to design our

products in a manner that does not infringe a valid patent. We may not prevail in any legal action, and a required license under the patent may not be available on acceptable terms or at all, requiring cessation of activities that were found to infringe a valid patent. We also may not be able to develop a non-infringing product design on commercially reasonable terms, or at all.

Moreover, certain components of AFREZZA and/or our cancer vaccines may be manufactured outside the United States and imported into the United States. As such, third parties could file complaints under 19 U.S.C. Section 337(a)(1)(B), or a 337 action, with the International Trade Commission, or the ITC. A 337 action can be expensive and would consume time and other resources. There is a risk that the ITC would decide that we are infringing a third party s patents and either enjoin us from importing the infringing products or parts thereof into the United States or set a bond in an amount that the ITC considers would offset our competitive advantage from the continued importation during the statutory review period. The bond could be up to 100% of the value of the patented products. We may not prevail in any legal action, and a required license under the patent may not be available on acceptable terms, or at all, resulting in a permanent injunction preventing any further importation of the infringing products or parts thereof into the United States. We also may not be able to develop a non-infringing product design on commercially reasonable terms, or at all.

Although we own a number of domestic and foreign patents and patent applications relating to AFREZZA and cancer vaccine products under development, we have identified certain third-party patents having claims relating to pulmonary insulin delivery that may trigger an allegation of infringement upon the commercial manufacture and sale of AFREZZA, as well as third-party patents disclosing methods of use and compositions of matter related to cancer vaccines that also may trigger an allegation of infringement upon the commercial manufacture and sale of our cancer immunotherapy. If a court were to determine that our insulin products or cancer therapies were infringing any of these patent rights, we would have to establish with the court that these patents were invalid or unenforceable in order to avoid legal liability for infringement of these patents. However, proving patent invalidity or unenforceability can be difficult because issued patents are presumed valid. Therefore, in the event that we are unable to prevail in a non-infringement or invalidity action we will have to either acquire the third-party patents outright or seek a royalty-bearing license. Royalty-bearing licenses effectively increase production costs and therefore may materially affect product profitability. Furthermore, should the patent holder refuse to either assign or license us the infringed patents, it may be necessary to cease manufacturing the product entirely and/or design around the patents, if possible. In either event, our business would be harmed and our profitability could be materially adversely impacted.

Furthermore, because of the substantial amount of discovery required in connection with intellectual property litigation, there is a risk that some of our confidential information could be compromised by disclosure during this type of litigation. In addition, during the course of this kind of litigation, there could be public announcements of the results of hearings, motions or other interim proceedings or developments. If securities analysts or investors perceive these results to be negative, the market price of our common stock may decline.

In addition, patent litigation may divert the attention of key personnel and we may not have sufficient resources to bring these actions to a successful conclusion. At the same time, some of our competitors may be able to sustain the costs of complex patent litigation more effectively than we can because they have substantially greater resources. An adverse determination in a judicial or administrative proceeding or failure to obtain necessary licenses could prevent us from manufacturing and selling our products or result in substantial monetary damages, which would adversely affect our business and results of operations and cause the market price of our common stock to decline.

We may not obtain trademark registrations for our potential trade names.

We have not selected trade names for some of our product candidates; therefore, we have not filed trademark registrations for all of our potential trade names for our product candidates in all jurisdictions, nor can we assure that we will be granted registration of those potential trade names for which we have filed. No assurance can be given that any of our trademarks will be registered in the United States or elsewhere or that the use of any of our trademarks will confer a competitive advantage in the marketplace. Furthermore, even if we are successful in our trademark registrations, the FDA has its own process for drug nomenclature and its own views concerning appropriate proprietary names. It also has the power, even after granting market approval, to request a company to reconsider the name for a product because of evidence of confusion in the marketplace. We cannot assure you that the FDA or any other regulatory authority will approve of any of our trademarks or will not request reconsideration of one of our trademarks at some time in the future.

RISKS RELATED TO OUR COMMON STOCK

Our stock price is volatile.

The stock market, particularly in recent years, has experienced significant volatility particularly with respect to pharmaceutical and biotechnology stocks, and this trend may continue. The volatility of pharmaceutical and biotechnology stocks often does not relate to the operating performance of the companies represented by the stock. Our business and the market price of our common stock may be influenced by

a large variety of factors, including:

- the progress and results of our clinical trials;
- general economic, political or stock market conditions;

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legislative developments;

announcements by us or our competitors concerning clinical trial results, acquisitions, strategic alliances, technological innovations, newly approved commercial products, product discontinuations, or other developments;

the availability of critical materials used in developing and manufacturing AFREZZA or other product candidates;

developments or disputes concerning our patents or proprietary rights;

the expense and time associated with, and the extent of our ultimate success in, securing regulatory approvals;

announcements by us concerning our financial condition or operating performance;

changes in securities analysts estimates of our financial condition or operating performance;

general market conditions and fluctuations for emerging growth and pharmaceutical market sectors;

sales of large blocks of our common stock, including sales by our executive officers, directors and significant stockholders;

the status of litigation against us and certain of our executive officers and directors;

the existence of, and the issuance of shares of our common stock pursuant to, the share lending agreement and the short sales of our common stock effected in connection with the sale of our 5.75% convertible notes due 2015; and

discussion of AFREZZA, our other product candidates, competitors products, or our stock price by the financial and scientific press, the healthcare community and online investor communities such as chat rooms. In particular, it may be difficult to verify statements about us and our investigational products that appear on interactive websites that permit users to generate content anonymously or under a pseudonym and statements attributed to company officials may, in fact, have originated elsewhere.

Any of these risks, as well as other factors, could cause the market price of our common stock to decline.

If other biotechnology and biopharmaceutical companies or the securities markets in general encounter problems, the market price of our common stock could be adversely affected.

Public companies in general and companies included on the NASDAQ Global Market in particular have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. There has been particular volatility in the market prices of securities of biotechnology and other life sciences companies, and the market prices of these companies have often fluctuated because of problems or successes in a given market segment or because investor interest has shifted to other segments. These broad market and industry factors may cause the market price of our common stock to decline, regardless of our operating performance. We have no control over this volatility and can only focus our efforts on our own operations, and even these may be affected due to the state of the capital markets.

In the past, following periods of large price declines in the public market price of a company s securities, securities class action litigation has often been initiated against that company. Litigation of this type could result in substantial costs and diversion of management s attention and resources, which would hurt our business. Any adverse determination in litigation could also subject us to significant liabilities.

Our Chairman and Chief Executive Officer and principal stockholder can individually control our direction and policies, and his interests may be adverse to the interests of our other stockholders. After his death, his stock will be left to his funding foundations for distribution to various charities, and we cannot assure you of the manner in which those entities will manage their holdings.*

At June 30, 2012, Mr. Mann beneficially owned approximately 41.2% of our outstanding shares of capital stock, excluding the 21,562,440 shares of common stock that may be issued from time to time upon exercise of the warrants issued in the February 2012 offering. If further effect is given to the issuance of 31,250,000 restricted shares of our common stock in the concurrent private placement issuable upon receipt of stockholder approval to increase the number of our authorized shares, as of June 30, 2012, Mr. Mann would have beneficially owned [approximately 41.7%] of our outstanding shares of capital stock. By virtue of his holdings, Mr. Mann may be able to continue to effectively control the election of the members of our board of directors, our management and our affairs and prevent corporate transactions such as mergers, consolidations or the sale of all or substantially all of our assets that may be favorable from our standpoint or that of our other stockholders or cause a transaction that we or our other stockholders may view as unfavorable.

Subject to compliance with United States federal and state securities laws, Mr. Mann is free to sell the shares of our stock he holds at any time. Upon his death, we have been advised by Mr. Mann that his shares of our capital stock will be left to the Alfred E. Mann Medical Research Organization, or AEMMRO, and AEM Foundation for Biomedical Engineering, or AEMFBE, not-for-profit medical research foundations that serve as funding organizations for Mr. Mann s various charities, including the Alfred Mann Foundation, or AMF, and the Alfred Mann Institutes at the University of Southern California, the Technion-Israel Institute of Technology, and Purdue University, and that may serve as funding organizations for any other charities that he may establish. The

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AEMMRO is a membership foundation consisting of six members, including Mr. Mann, his wife, three of his children and Dr. Joseph Schulman, the chief scientist of the AEMFBE. The AEMFBE is a membership foundation consisting of five members, including Mr. Mann, his wife, and the same three of his children. Although we understand that the members of AEMMRO and AEMFBE have been advised of Mr. Mann s objectives for these foundations, once Mr. Mann s shares of our capital stock become the property of the foundations, we cannot assure you as to how those shares will be distributed or how they will be voted.

The future sale of our common stock, the conversion of our senior convertible notes into common stock or the exercise of our warrants for common stock could negatively affect our stock price.*

As of June 30, 2012, we had 199,300,833 shares of common stock outstanding. Substantially all of these shares are available for public sale, subject in some cases to volume and other limitations or delivery of a prospectus. If our common stockholders sell substantial amounts of common stock in the public market, or the market perceives that such sales may occur, the market price of our common stock may decline. Likewise the issuance of additional shares of our common stock upon the conversion of some or all of our senior convertible notes, or upon the exercise of some or all of the warrants we issued in February 2012, could adversely affect the trading price of our common stock. In addition, the existence of these notes and warrants may encourage short selling of our common stock by market participants. Furthermore, if we were to include in a company-initiated registration statement shares held by our stockholders pursuant to the exercise of their registration rights, the sale of those shares could impair our ability to raise needed capital by depressing the price at which we could sell our common stock.

In addition, we will need to raise substantial additional capital in the future to fund our operations. If we raise additional funds by issuing equity securities or additional convertible debt, the market price of our common stock may decline and our existing stockholders may experience significant dilution.

Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may prevent attempts by our stockholders to replace or remove our current management.

We are incorporated in Delaware. Certain anti-takeover provisions under Delaware law and in our certificate of incorporation and amended and restated bylaws, as currently in effect, may make a change of control of our company more difficult, even if a change in control would be beneficial to our stockholders. Our anti-takeover provisions include provisions such as a prohibition on stockholder actions by written consent, the authority of our board of directors to issue preferred stock without stockholder approval, and supermajority voting requirements for specified actions. In addition, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which generally prohibits stockholders owning 15% or more of our outstanding voting stock from merging or combining with us in certain circumstances. These provisions may delay or prevent an acquisition of us, even if the acquisition may be considered beneficial by some of our stockholders. In addition, they may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management.

Because we do not expect to pay dividends in the foreseeable future, you must rely on stock appreciation for any return on your investment.

We have paid no cash dividends on any of our capital stock to date, and we currently intend to retain our future earnings, if any, to fund the development and growth of our business. As a result, we do not expect to pay any cash dividends in the foreseeable future, and payment of cash dividends, if any, will also depend on our financial condition, results of operations, capital requirements and other factors and will be at the discretion of our board of directors. Furthermore, we may in the future become subject to contractual restrictions on, or prohibitions against, the payment of dividends. Accordingly, the success of your investment in our common stock will likely depend entirely upon any future appreciation. There is no guarantee that our common stock will appreciate or maintain its current price. You could lose the entire value of your investment in our common stock.

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

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. Mine Safety Disclosures

Not applicable.

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ITEM 5. OTHER INFORMATION

On January 1, 2012, we adopted 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income (ASU 2011-05) which requires presentation of the components of net income (loss) and other comprehensive income (loss) either as one continuous statement or as two consecutive statements and eliminates the option to present components of other comprehensive income as part of the statement of changes in stockholders equity. The following presents the retrospective application of ASU 2011-05 for each of the three years ended December 31:

Consolidated Statements of Comprehensive Loss

MannKind Corporation and Subsidiaries

Thousands,

for the Three Years Ended December 31,	**2011**	**2010**	**2009**
Net loss	$ (160,804)	$ (170,560)	$ (220,104)
Other comprehensive loss:			
Cumulative translation (loss) gain	(3)	(6)	5
Unrealized gain (loss) on investments:			
Unrealized holding gain (loss)	(27)	(361)	(581)
Less: reclassification adjustment for gains (losses) included in net loss	0	0	0
Net unrealized (loss) gain on investments	(27)	(361)	(581)
Comprehensive loss	$ (160,834)	$ (170,927)	$ (220,680)

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ITEM 6. EXHIBITS

Exhibit Number	Description of Document
3.1(1)	Amended and Restated Certificate of Incorporation.
3.2(2)	Certificate of Amendment of Amended and Restated Certificate of Incorporation.
3.3(3)	Certificate of Amendment of Amended and Restated Certificate of Incorporation.
3.4(4)	Certificate of Amendment of Amended and Restated Certificate of Incorporation.
3.4(11)	Certificate of Amendment of Amended and Restated Certificate of Incorporation.
3.5(5)	Amended and Restated Bylaws.
4.1(6)	Indenture, by and between MannKind and Wells Fargo Bank, N.A., dated November 1, 2006.
4.2(7)	First Supplemental Indenture, by and between MannKind and Wells Fargo Bank, N.A., dated December 12, 2006.
4.3(7)	Form of 3.75% Senior Convertible Note due 2013.
4.4(1)	Form of common stock certificate.
4.5(1)	Registration Rights Agreement, dated October 15, 1998, by and among CTL ImmunoTherapies Corp., Medical Research Group, LLC, McLean Watson Advisory Inc. and Alfred E. Mann, as amended.
4.6(8)	Indenture, by and between MannKind and Wells Fargo Bank, N.A., dated August 24, 2010.
4.7(8)	Form of 5.75% Senior Convertible Note due 2015.
4.8(9)	Form of Warrant to Purchase Common Stock issued February 8, 2012.
10.1(12)	MannKind Corporation 2004 Equity Incentive Plan, as amended.
10.2(13)	Amendment, dated May 9, 2012, to Amended and Restated Promissory Note made by MannKind in favor of The Mann Group LLC, dated August 10, 2010, as amended January 16, 2012
10.3(14)	Amendment, dated June 27, 2012, to Amended and Restated Promissory Note made by MannKind Corporation in favor of The Mann Group LLC, dated August 10, 2010, as amended on January 16, 2012 and May 9, 2012.
31.1	Certification of the Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of the Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32	Certifications of the Chief Executive Officer and Chief Financial Officer Pursuant to Rule 13a-14(b) or 15d-14(b) of the Securities Exchange Act of 1934, as amended and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. § 1350).
101	Interactive Data Files pursuant to Rule 405 of Regulation S-T.

(1) Incorporated by reference to MannKind s registration statement on Form S-1 (File No. 333-115020), filed with the SEC on April 30, 2004, as amended.
(2) Incorporated by reference to MannKind s quarterly report on Form 10-Q (File No. 000-50865), filed with the SEC on August 9, 2007.
(3) Incorporated by reference to MannKind s quarterly report on Form 10-Q (File No. 000-50865), filed with the SEC on August 2, 2010.
(4) Incorporated by reference to MannKind s quarterly report on Form 10-Q (File No. 000-50865), filed with the SEC on August 4, 2011.
(5) Incorporated by reference to MannKind s current report on Form 8-K (File No. 000-50865), filed with the SEC on November 19, 2007.
(6) Incorporated by reference to MannKind s registration statement on Form S-3 (File No. 333-138373), filed with the SEC on November 2, 2006.

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(7) Incorporated by reference to MannKind s current report on Form 8-K (File No. 000-50865), filed with the SEC on December 12, 2006.
(8) Incorporated by reference to MannKind s current report on Form 8-K (File No. 000-50865), filed with the SEC on August 24, 2010.
(9) Incorporated by reference to MannKind s current report on Form 8-K (File No. 000-50865), filed with the SEC on February 6, 2012.
(10) Incorporated by reference to MannKind s current report on Form 8-K (File No. 000-50865), filed with the SEC on January 20, 2012.
(11) Incorporated by reference to MannKind s current report on Form 8-K (File No. 000-50865), filed with the SEC on May 22, 2012.
(12) Incorporated by reference to Mannkind s proxy statement on Schedule 14A (File No. 000-50865), filed with the SEC on April 6, 2012.
(13) Incorporated by reference to Exhibit 10.3 to Mannkind s quarterly report on Form 10-Q (File No. 000-50865), filed with the SEC on May 10, 2012.
(14) Incorporated by reference to Mannkind s current report on Form 8-K (File No. 000-50865), filed with the SEC on July 3, 2012.

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SIGNATURE

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

Dated: August 9, 2012

MANNKIND CORPORATION

By: /s/ MATTHEW J. PFEFFER
Matthew J. Pfeffer
Corporate Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)

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