

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

**FORM 10-Q**

(Mark One)

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

For the Quarterly Period Ended March 31, 2010

or

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-30111

**Lexicon Pharmaceuticals, Inc.**  
(Exact Name of Registrant as Specified in its Charter)

Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization)

76-0474169  
(I.R.S. Employer  
Identification Number)

8800 Technology Forest Place  
The Woodlands, Texas 77381  
(Address of Principal Executive Offices and Zip Code)

(281) 863-3000  
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes \_\_\_\_\_  \_\_\_\_\_ No \_\_\_\_\_

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes \_\_\_\_\_ No \_\_\_\_\_

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

Large accelerated filer \_\_\_\_\_ Accelerated filer  \_\_\_\_\_ Non-accelerated filer \_\_\_\_\_ Smaller reporting company \_\_\_\_\_

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes \_\_\_\_\_ No  \_\_\_\_\_

As of May 6, 2010, 337,404,194 shares of the registrant's common stock, par value \$0.001 per share, were outstanding.

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**Factors Affecting Forward Looking Statements**

This quarterly report on Form 10-Q contains forward-looking statements. These statements relate to future events or our future financial performance. We have attempted to identify forward-looking statements by terminology including “anticipate,” “believe,” “can,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “plan,” “potential,” “predict,” “should” or “will” or the negative of these terms or other comparable terminology. These statements are only predictions and involve known and unknown risks, uncertainties and other factors, including the risks outlined under “Part II, Item 1A. – Risk Factors,” that may cause our or our industry’s actual results, levels of activity, performance or achievements to be materially different from any future results, levels or activity, performance or achievements expressed or implied by these forward-looking statements.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We are not under any duty to update any of the forward-looking statements after the date of this quarterly report on Form 10-Q to conform these statements to actual results, unless required by law.

**Part I – Financial Information****Item 1. Financial Statements****Lexicon Pharmaceuticals, Inc.****Consolidated Balance Sheets  
(In thousands, except par value)**

<b>Assets</b>	<b>As of March 31, 2010 (unaudited)</b>	<b>As of December 31, 2009</b>
<b>Current assets:</b>		
Cash and cash equivalents	\$ 260,126	\$ 100,554
Short-term investments, including restricted investments of \$430	54,055	56,542
Short-term investments held by Symphony Icon, Inc. (Note 4)	—	5,417
Accounts receivable, net of allowances of \$35	1,969	815
Prepaid expenses and other current assets	5,757	6,356
Total current assets	321,907	169,684
Property and equipment, net of accumulated depreciation and amortization of \$76,015 and \$75,795, respectively	57,850	58,754
Goodwill	25,798	25,798
Other assets	3,656	3,325
Total assets	<u>\$ 409,211</u>	<u>\$ 257,761</u>
<b>Liabilities and Equity</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 4,773	\$ 5,919
Accrued liabilities	5,368	5,611
Current portion of deferred revenue	576	942
Current portion of long-term debt	36,599	38,482
Total current liabilities	47,316	50,954
Deferred revenue, net of current portion	14,212	14,212
Long-term debt	28,199	28,482
Other long-term liabilities	579	616
Total liabilities	90,306	94,264
<b>Commitments and contingencies</b>		
<b>Equity:</b>		
Lexicon Pharmaceuticals, Inc. stockholders' equity:		
Preferred stock, \$.01 par value; 5,000 shares authorized; no shares issued and outstanding	—	—
Common stock, \$.001 par value; 900,000 shares authorized; 337,562 and 175,785 shares issued, respectively	338	176
Additional paid-in capital	916,505	733,874
Accumulated deficit	(597,701)	(570,175)
Treasury stock, at cost, 158 and 80 shares, respectively	(237)	(88)
Total Lexicon Pharmaceuticals, Inc. stockholders' equity	318,905	163,787
Noncontrolling interest in Symphony Icon, Inc. (Note 4)	—	(290)
Total equity	318,905	163,497
Total liabilities and equity	<u>\$ 409,211</u>	<u>\$ 257,761</u>

*The accompanying notes are an integral part of these consolidated financial statements.*

## Lexicon Pharmaceuticals, Inc.

**Consolidated Statements of Operations**  
**(In thousands, except per share amounts)**  
**(Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
Revenues:		
Collaborative research	\$ 1,641	\$ 3,605
Subscription and license fees	—	563
Total revenues	1,641	4,168
Operating expenses:		
Research and development, including stock-based compensation of \$806 and \$829, respectively	21,088	22,864
General and administrative, including stock-based compensation of \$499 and \$613, respectively	5,519	4,874
Total operating expenses	26,607	27,738
Loss from operations	(24,966)	(23,570)
Gain on investments, net	88	517
Interest income	217	327
Interest expense	(727)	(666)
Other expense, net	(682)	(945)
Consolidated net loss	(26,070)	(24,337)
Less: Net loss attributable to noncontrolling interest in Symphony Icon, Inc. (Note 4)	—	2,777
Net loss attributable to Lexicon Pharmaceuticals, Inc.	<u>\$ (26,070)</u>	<u>\$ (21,560)</u>
Net loss attributable to Lexicon Pharmaceuticals, Inc. per common share, basic and diluted	\$ (0.13)	\$ (0.16)
Shares used in computing net loss attributable to Lexicon Pharmaceuticals, Inc. per common share, basic and diluted	197,239	137,075

*The accompanying notes are an integral part of these consolidated financial statements.*

**Lexicon Pharmaceuticals, Inc.**
**Consolidated Statements of Stockholders' Equity**  
**(In thousands)**  
**(Unaudited)**

Lexicon Pharmaceuticals, Inc. Stockholders										
	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss		Treasury Stock	Total	Noncontrolling Interest (Note 4)	Total Equity
	Shares	Par Value			Comprehensive Loss	Total				
<b>Balance at December 31, 2008</b>	136,797	\$ 137	\$ 672,838	\$ (487,395)	\$ —	\$ —	\$ 185,580	\$ 10,247	\$ 195,827	
Stock-based compensation	—	—	1,807	—	—	—	1,807	—	1,807	
Grant of restricted stock	534	—	—	—	—	—	—	—	—	
Net loss	—	—	—	(21,560)	—	—	(21,560)	(2,777)	(24,337)	
Unrealized loss on investments	—	—	—	—	(5)	—	(5)	—	(5)	
Comprehensive loss	—	—	—	—	—	—	(21,565)	—	(24,342)	
<b>Balance at March 31, 2009</b>	<b>137,331</b>	<b>\$ 137</b>	<b>\$ 674,645</b>	<b>\$ (508,955)</b>	<b>\$ (5)</b>	<b>\$ —</b>	<b>\$ 165,822</b>	<b>\$ 7,470</b>	<b>\$ 173,292</b>	
<b>Balance at December 31, 2009</b>	175,785	\$ 176	\$ 733,874	\$ (570,175)	\$ —	\$ (88)	\$ 163,787	\$ (290)	\$ 163,497	
Deconsolidation of Symphony Icon	—	—	—	—	—	—	—	290	290	
Cumulative-effect adjustment for adoption of new accounting principle	—	—	—	(1,456)	—	—	(1,456)	—	(1,456)	
Stock-based compensation	—	—	1,305	—	—	—	1,305	—	1,305	
Issuance of common stock, net of fees	161,770	162	181,309	—	—	—	181,471	—	181,471	
Exercise of common stock options	7	—	17	—	—	—	17	—	17	
Repurchase of common stock	—	—	—	—	—	(149)	(149)	—	(149)	
Net loss	—	—	—	(26,070)	—	—	(26,070)	—	(26,070)	
<b>Balance at March 31, 2010</b>	<b>337,562</b>	<b>\$ 338</b>	<b>\$ 916,505</b>	<b>\$ (597,701)</b>	<b>\$ —</b>	<b>\$ (237)</b>	<b>\$ 318,905</b>	<b>\$ —</b>	<b>\$ 318,905</b>	

The accompanying notes are an integral part of these consolidated financial statements.

## Lexicon Pharmaceuticals, Inc.

**Consolidated Statements of Cash Flows**  
(In thousands)  
(Unaudited)

	Three Months Ended March 31,	
	2010	2009
Cash flows from operating activities:		
Consolidated net loss	\$ (26,070)	\$ (24,337)
Adjustments to reconcile consolidated net loss to net cash used in operating activities:		
Depreciation	1,380	1,772
Impairment of fixed assets	—	406
Amortization of Symphony Icon, Inc. purchase option	678	535
Stock-based compensation	1,305	1,442
(Gain) loss on auction rate securities (“ARS”)	(2,238)	41
Loss (gain) on ARS Rights	2,150	(558)
Loss on disposal of property and equipment	—	2
Changes in operating assets and liabilities:		
Increase in accounts receivable	(737)	(680)
Decrease in prepaid expenses and other current assets	3,285	1,784
Decrease in other assets	24	26
Decrease in accounts payable and other liabilities	(1,111)	(6,024)
Decrease in deferred revenue	(366)	(2,563)
Net cash used in operating activities	(21,700)	(28,154)
Cash flows from investing activities:		
Purchases of property and equipment	(485)	(156)
Proceeds from disposal of property and equipment	9	36
Maturities of investments held by Symphony Icon, Inc. (Note 4)	—	4,778
Purchases of investments	—	(59,955)
Maturities of investments	2,575	100
Net cash provided by (used in) investing activities	2,099	(55,197)
Cash flows from financing activities:		
Proceeds from issuance of common stock	181,488	—
Repurchase of common stock	(149)	—
Proceeds from debt borrowings	750	14,800
Repayment of debt borrowings	(2,916)	(369)
Net cash provided by financing activities	179,173	14,431
Net increase (decrease) in cash and cash equivalents	159,572	(68,920)
Cash and cash equivalents at beginning of period	100,554	85,873
Cash and cash equivalents at end of period	\$ 260,126	\$ 16,953
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 606	\$ 626
Supplemental disclosure of non-cash investing and financing activities:		
Unrealized loss on investments	\$ —	\$ (5)

*The accompanying notes are an integral part of these consolidated financial statements.*

**Lexicon Pharmaceuticals, Inc.**

**Notes to Consolidated Financial Statements  
(Unaudited)**

**1. Basis of Presentation**

The accompanying unaudited consolidated financial statements of Lexicon Pharmaceuticals, Inc. (“Lexicon” or the “Company”) have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three-month period ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ended December 31, 2010.

The accompanying consolidated financial statements include the accounts of Lexicon and its wholly-owned subsidiaries. Intercompany transactions and balances are eliminated in consolidation. In 2009, the consolidated financial statements also include the accounts of one variable interest entity, Symphony Icon, Inc. (“Symphony Icon”), for which the Company was the primary beneficiary and therefore had consolidated the financial condition and results of operations of Symphony Icon. Upon the adoption of a new accounting pronouncement regarding variable interest entities (formerly Statement of Financial Accounting Standards (“SFAS”) No. 167, “Amendments to FASB Interpretation No. 46(R)”) on January 1, 2010, Lexicon determined that it is no longer the primary beneficiary of Symphony Icon, and is therefore no longer consolidating the financial condition and results of operations of Symphony Icon.

Certain amounts in the prior year’s financial statements have been reclassified to conform to the current year presentation. These include the reclassification of \$112,000 of patent-related legal costs from research and development expense to general and administrative expense on the consolidated statement of operations for the three months ended March 31, 2009.

For further information, refer to the financial statements and footnotes thereto included in Lexicon’s annual report on Form 10-K for the year ended December 31, 2009, as filed with the SEC.

**2. Net Loss Per Share**

Net loss per share is computed using the weighted average number of shares of common stock outstanding during the applicable period. Shares associated with stock options and warrants are not included because they are antidilutive. There are no differences between basic and diluted net loss per share for all periods presented.

**3. Stock-Based Compensation**

The Company recorded \$1.3 million and \$1.4 million of stock-based compensation expense for the three months ended March 31, 2010 and 2009, respectively. The Company utilized the Black-Scholes valuation model for estimating the fair value of the stock compensation granted, with the following weighted-average assumptions for options granted in the three months ended March 31, 2010 and 2009:

	<u>Expected Volatility</u>	<u>Risk-free Interest Rate</u>	<u>Expected Term</u>	<u>Estimated Forfeitures</u>	<u>Dividend Rate</u>
March 31, 2010:					
Employees	86%	2.4%	5	22%	0%
Officers and non-employee directors	80%	3.3 %	8	7%	0 %
March 31, 2009:					
Employees	78%	1.9%	5	23%	0%
Officers and non-employee directors	76%	2.6%	8	6%	0%

The following is a summary of option activity under Lexicon's stock option plans for the three months ended March 31, 2010:

	<u>Options (in thousands)</u>	<u>Weighted Average Exercise Price</u>
Outstanding at December 31, 2009	17,346	\$ 4.16
Granted	4,517	1.90
Exercised	(7)	2.50
Expired	(1,439)	4.13
Forfeited	(263)	1.55
Outstanding at March 31, 2010	<u>20,154</u>	<u>3.69</u>
Exercisable at March 31, 2010	<u>10,554</u>	\$ 5.34

During 2009, Lexicon granted its officers restricted stock bonus awards in lieu of cash bonus awards. The shares subject to the awards vested in two installments over the one-year period following the date of grant. The following is a summary of restricted stock activity under Lexicon's stock option plans for the three months ended March 31, 2010:

	<u>Shares (in thousands)</u>	<u>Weighted Average Grant Date Fair Value</u>
Outstanding at December 31, 2009	255	\$ 1.45
Vested	(255)	1.45
Nonvested at March 31, 2010	<u>—</u>	\$ —

During the three months ended March 31, 2010, Lexicon granted certain employees restricted stock units with a performance condition. The shares subject to the restricted stock units vest upon the dosing of the first patient in a pivotal human clinical trial in any country, the results of which could be used to establish safety and efficacy of a pharmaceutical product discovered or developed by Lexicon as a basis for a New Drug Application. Stock-based compensation expense for awards with performance conditions is recognized over the period from the date the performance condition is determined to be probable of occurring through the time the applicable condition is met. The following is a summary of restricted stock units activity under Lexicon's stock option plans for the three months ended March 31, 2010:

	<u>Shares (in thousands)</u>	<u>Weighted Average Grant Date Fair Value</u>
Outstanding at December 31, 2009	—	\$ —
Granted	387	1.90
Nonvested at March 31, 2010	<u>387</u>	\$ 1.90



**4. Recent Accounting Pronouncements**

In June 2009, the Financial Accounting Standards Board (“FASB”) issued a new accounting pronouncement regarding variable interest entities (formerly SFAS No. 167) which changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity’s purpose and design and a company’s ability to direct the activities that most significantly impacts the entity’s economic performance. The impact of the adoption of this pronouncement may be applied retrospectively with a cumulative-effect adjustment to retained earnings as of the beginning of the first year restated, or through a cumulative-effect adjustment on the date of adoption. This pronouncement, found under FASB ASC Topic 810, is effective for fiscal years, and interim periods within those fiscal years, beginning on or after November 15, 2009. The Company has determined that upon adoption of this pronouncement on January 1, 2010, Lexicon is no longer the primary beneficiary of Symphony Icon, and therefore has not included the financial condition and results of operations of Symphony Icon in its consolidated financial statements as of and for the three months ended March 31, 2010. As of December 31, 2009, Symphony Icon had \$6.2 million in current assets, \$5.4 million of which was short-term investments, and \$4.2 million in current liabilities. On January 1, 2010, Lexicon recorded a cumulative-effect adjustment to retained earnings (accumulated deficit) as a result of adopting this pronouncement, which increased the accumulated deficit balance by \$1.5 million.

In October 2009, the FASB issued Accounting Standards Update (“ASU”) No. 2009-13, “Multiple-Deliverable Revenue Arrangements”, which amends FASB ASC Topic 605. ASU No. 2009-13 addresses how to determine whether an arrangement involving multiple deliverables contain more than one unit of accounting and how to allocate consideration to each unit of accounting in the arrangement. This pronouncement replaces all references to fair value as the measurement criteria with the term selling price and establishes a hierarchy for determining the selling price of a deliverable. The pronouncement also eliminates the use of the residual value method for determining the allocation of arrangement consideration, and requires additional disclosures. This pronouncement should be applied prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. This pronouncement’s impact on accounting for revenue arrangements is dependent upon arrangements entered into on or after that time.

**5. Cash and Cash Equivalents and Investments**

The fair value of cash and cash equivalents and investments held at March 31, 2010 and December 31, 2009 are as follows:

	As of March 31, 2010			Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
	(in thousands)			
Cash and cash equivalents	\$ 260,126	\$ —	\$ —	\$ 260,126
Securities maturing within one year:				
Certificates of deposit	508	—	—	508
ARS Rights	—	7,575	—	7,575
Securities maturing after ten years:				
Auction rate securities	53,600	—	(7,628)	45,972
Total short-term investments	\$ 54,108	\$ 7,575	\$ (7,628)	\$ 54,055
Total cash and cash equivalents and investments	\$ 314,234	\$ 7,575	\$ (7,628)	\$ 314,181

	As of December 31, 2009			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
Cash and cash equivalents	\$ 100,554	\$ —	\$ —	\$ 100,554
Securities maturing within one year:				
Certificates of deposit	508	—	—	508
ARS rights	—	9,725	—	9,725
Securities maturing after ten years:				
Auction rate securities	56,175	—	(9,866)	46,309
Total short-term investments	\$ 56,683	\$ 9,725	\$ (9,866)	\$ 56,542
Short-term investments held by Symphony Icon, Inc.:				
Cash and cash equivalents	5,417	—	—	5,417
Total short-term investments held by Symphony Icon, Inc.	\$ 5,417	\$ —	\$ —	\$ 5,417
Total cash and cash equivalents and investments	\$ 162,654	\$ 9,725	\$ (9,866)	\$ 162,513

There were no realized gains or losses for the three months ended March 31, 2010 and 2009, respectively. The cost of securities sold is based on the specific identification method.

At March 31, 2010, Lexicon held \$53.6 million (par value), with an estimated fair value of \$46.0 million, of investments with an auction interest rate reset feature, known as auction rate securities. At December 31, 2009, Lexicon held \$56.2 million (par value), with an estimated fair value of \$46.3 million, of auction rate securities. These notes are issued by various state agencies for the purpose of financing student loans. The securities have historically traded at par and are redeemable at par plus accrued interest at the option of the issuer. Interest is typically paid at the end of each auction period or semiannually. Until February 2008, the market for Lexicon's auction rate securities was highly liquid. However, starting in February 2008, a substantial number of auctions "failed," meaning that there was not enough demand to sell all of the securities that holders desired to sell at auction. The immediate effect of a failed auction is that such holders cannot sell the securities at auction and the interest rate on the security generally resets to a maximum interest rate. In the case of funds invested by Lexicon in auction rate securities which are the subject of a failed auction, Lexicon may not be able to access the funds without a loss of principal unless a future auction on these investments is successful or the issuer redeems the security. Lexicon has modified its current investment strategy to reallocate its investments more into U.S. treasury securities and U.S. treasury-backed money market investments.

At March 31, 2010 and December 31, 2009, observable auction rate securities market information was not available to determine the fair value of Lexicon's investments. Lexicon has estimated the fair value of these securities at \$46.0 million and \$46.3 million as of March 31, 2010 and December 31, 2009, respectively, using models of the expected future cash flows related to the securities and taking into account assumptions about the cash flows of the underlying student loans, as well as secondary market trading data. The assumptions used in preparing the discounted cash flow model include estimates of interest rates, timing and amount of cash flows, liquidity premiums and expected holding periods of the auction rate securities, based on data available as of March 31, 2010 and December 31, 2009. The underlying assumptions are volatile and are subject to change as market conditions change.

In November 2008, Lexicon accepted an offer from UBS AG, the investment bank that sold Lexicon the auction rate securities, providing Lexicon with rights related to its auction rate securities ("ARS Rights"). The ARS Rights permit Lexicon to require UBS to purchase its \$53.6 million (par value) of auction rate securities at par value during the period from June 30, 2010 through July 2, 2012. Conversely, UBS has the right, in its discretion, to purchase or sell the securities at any time by paying Lexicon the par value of such securities. Management expects to exercise the ARS Rights and sell Lexicon's auction rate securities back to UBS on June 30, 2010, the earliest date allowable under the ARS Rights. Lexicon is also eligible to borrow from UBS Bank US A, an affiliate of UBS, at no net cost up to 75% of the market value of the securities, as determined by UBS Bank USA, which loans would become payable upon the purchase or sale of the securities by UBS (see note 7).

The enforceability of the ARS Rights results in a separate asset that is measured at its fair value. Lexicon elected to measure the ARS Rights under a fair value option, which permits entities to choose, at certain election dates, to measure eligible items at fair value. As a result of accepting the ARS Rights, Lexicon has elected to classify the ARS Rights and reclassify its investments in auction rate securities as trading securities from available-for-sale securities. As a result, Lexicon is required to assess the fair value of these two individual assets and record changes each period until the ARS Rights are exercised and the auction rate securities are redeemed. Lexicon expects that subsequent changes in the value of the ARS Rights will largely offset the subsequent fair value movements of the auction rate securities, subject to the continued expected performance by the investment bank of its obligations under the agreement.

## 6. Fair Value Measurements

The Company uses various inputs in determining the fair value of its investments and measures these assets on a recurring basis. Financial assets recorded at fair value in the consolidated balance sheets are categorized by the level of objectivity associated with the inputs used to measure their fair value. The following levels are directly related to the amount of subjectivity associated with the inputs to fair valuation of these financial assets:

- Level 1 – quoted prices in active markets for identical investments
- Level 2 – other significant observable inputs (including quoted prices for similar investments, market corroborated inputs, etc.)
- Level 3 – significant unobservable inputs (including the Company’s own assumptions in determining the fair value of investments)

The inputs or methodology used for valuing securities are not necessarily an indication of the credit risk associated with investing in those securities. The following table provides the fair value measurements of applicable Company financial assets that are measured at fair value on a recurring basis according to the fair value levels described above as of March 31, 2010 and December 31, 2009.

<b>Financial Assets at Fair Value as of March 31, 2010</b>				
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	(in thousands)			
Cash and cash equivalents	\$ 260,126	\$ —	\$ —	\$ 260,126
Short-term investments	508	—	53,547	54,055
<b>Total cash and cash equivalents and investments</b>	<b>\$ 260,634</b>	<b>\$ —</b>	<b>\$ 53,547</b>	<b>\$ 314,181</b>

<b>Financial Assets at Fair Value as of December 31, 2009</b>				
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	(in thousands)			
Cash and cash equivalents	\$ 100,554	\$ —	\$ —	\$ 100,554
Short-term investments	508	—	56,034	56,542
Short-term investments held by Symphony Icon, Inc.	5,417	—	—	5,417
<b>Total cash and cash equivalents and investments</b>	<b>\$ 106,479</b>	<b>\$ —</b>	<b>\$ 56,034</b>	<b>\$ 162,513</b>

The table presented below summarizes the change in consolidated balance sheet carrying value associated with Level 3 financial assets for the three months ended March 31, 2010 and 2009.

	<u>Short-term Investments</u>	<u>Long-term Investments</u>	<u>Total</u>
	(in thousands)		
Balance at December 31, 2009	\$ 56,034	\$ —	\$ 56,034
Unrealized gains included in earnings as gain on investments, net	88	—	88
Net sales and settlements	(2,575)	—	(2,575)
Balance at March 31, 2010	<u>\$ 53,547</u>	<u>\$ —</u>	<u>\$ 53,547</u>
Balance at December 31, 2008	\$ —	\$ 55,686	\$ 55,686
Unrealized gains included in earnings as gain on investments, net	—	517	517
Balance at March 31, 2009	<u>\$ —</u>	<u>\$ 56,203</u>	<u>\$ 56,203</u>

The Company also has assets that under certain conditions are subject to measurement at fair value on a non-recurring basis. These assets include goodwill associated with the acquisition of Coelacanth Corporation in 2001. For these assets, measurement at fair value in periods subsequent to their initial recognition is applicable if one or more is determined to be impaired.

## 7. Debt Obligations

*Mortgage Loan.* In April 2004, Lexicon obtained a \$34.0 million mortgage on its facilities in The Woodlands, Texas. The mortgage loan has a ten-year term with a 20-year amortization and bears interest at a fixed rate of 8.23%. The mortgage had a principal balance outstanding of \$29.3 million as of March 31, 2010. The fair value of Lexicon's mortgage loan approximates its carrying value. The fair value of Lexicon's mortgage loan is estimated using discounted cash flow analysis, based on the Company's current incremental borrowing rate.

*UBS Credit Line.* In January 2009, Lexicon entered into a credit line agreement with UBS Bank USA that provides, as of March 31, 2010, up to an aggregate amount of \$35.7 million in the form of an uncommitted, demand, revolving line of credit. Lexicon entered into the credit line in connection with its acceptance of an offer from UBS AG, the investment bank that sold Lexicon its auction rate securities, providing Lexicon with rights to require UBS to purchase its \$53.6 million (par value) of auction rate securities at par value during the period from June 30, 2010 through July 2, 2012. The credit line is secured only by these auction rate securities and advances under the credit line are made on a "no net cost" basis, meaning that the interest paid by Lexicon on advances will not exceed the interest or dividends paid to Lexicon by the issuer of the auction rate securities. The interest rate paid on the line of credit is less than the Company's estimated current incremental borrowing rate. As of March 31, 2010, Lexicon had \$35.5 million outstanding under this credit line.

## 8. Arrangements with Symphony Icon, Inc.

On June 15, 2007, Lexicon entered into a series of related agreements providing for the financing of the clinical development of certain of our drug candidates, including LX1031 and LX1032, along with any other pharmaceutical compositions modulating the same targets as those drug candidates (the "Programs"). The agreements include a Novated and Restated Technology License Agreement pursuant to which the Company licensed to Symphony Icon, a wholly-owned subsidiary of Symphony Icon Holdings LLC ("Holdings"), the Company's intellectual property rights related to the Programs. Holdings contributed \$45 million to Symphony Icon in order to fund the clinical development of the Programs.

Under a Share Purchase Agreement, dated June 15, 2007, between the Company and Holdings, the Company issued and sold to Holdings 7,650,622 shares of its common stock on June 15, 2007 in exchange for \$15 million and the Purchase Option (as defined below).

Under a Purchase Option Agreement, dated June 15, 2007, among the Company, Symphony Icon and Holdings, the Company received from Holdings an exclusive purchase option (the "Purchase Option") that gives the Company the right to acquire all of the equity of Symphony Icon, thereby allowing the Company to reacquire all of the Programs. The Purchase Option is exercisable by the Company at any time, in its sole discretion, until June 15, 2011 at an exercise price of (i) \$81 million, if the Purchase Option is exercised before June 15, 2010 and (ii) \$90 million, if the Purchase Option is exercised on or after June 15, 2010 and before June 15, 2011. The Purchase Option exercise price may be paid in cash or a combination of cash and common stock, at the Company's sole discretion, provided that the common stock portion may not exceed 40% of the Purchase Option exercise price. Lexicon originally calculated the value of the Purchase Option as the difference between the fair value of the common stock issued to Holdings of \$23.6 million (calculated at the time of issuance) and the \$15.0 million in cash received from Holdings for the issuance of the common stock. Lexicon has recorded the value of the Purchase Option as an asset, and is amortizing this asset over the four-year option period. Upon the adoption of a new accounting pronouncement regarding variable interest entities (formerly SFAS No. 167) on January 1, 2010, \$2.3 million of structuring and legal fees originally allocated to noncontrolling interest was allocated to the value of the Purchase Option. This resulted in a cumulative-effect adjustment to retained earnings of \$1.5 million, representing the additional amortization expense that would have been recorded through December 31, 2009. The unamortized balance of \$3.3 million and \$3.1 million is recorded in other assets in the accompanying consolidated balance sheets as of March 31, 2010 and December 31, 2009, respectively, and the amortization expense of \$678,000 and \$535,000 is recorded in other expense, net in the accompanying consolidated statements of operations for the three months ended March 31, 2010 and 2009, respectively.

Under an Amended and Restated Research and Development Agreement, dated June 15, 2007, among the Company, Symphony Icon and Holdings (the "R&D Agreement"), Symphony Icon and the Company are developing the Programs in accordance with a specified development plan and related development budget. The R&D Agreement provides that the Company will continue to be primarily responsible for the development of the Programs. The Company's development activities are supervised by Symphony Icon's development committee, which is comprised of an equal number of representatives from the Company and Symphony Icon. The development committee reports to Symphony Icon's board of directors, which is currently comprised of five members, including one member designated by the Company and two independent directors.

Under a Research Cost Sharing, Payment and Extension Agreement, dated June 15, 2007, among the Company, Symphony Icon and Holdings, upon the recommendation of the development committee, Symphony Icon's board of directors may require the Company to pay Symphony Icon up to \$15 million for Symphony Icon's use in the development of the Programs in accordance with the specified development plan and related development budget. The development committee's right to recommend that Symphony Icon's board of directors submit such funding requirement to the Company will terminate on the one-year anniversary of the expiration of the Purchase Option, subject to limited exceptions. Through March 2010, Symphony Icon's board of directors has requested the Company to pay Symphony Icon \$5.3 million under this agreement, all of which has been paid through March 31, 2010, and management expects that additional funding will be needed in the future.

Prior to January 1, 2010, Lexicon had determined that Symphony Icon was a variable interest entity for which it is the primary beneficiary. This determination was based on Holdings' lack of controlling rights with respect to Symphony Icon's activities and the limitation on the amount of expected residual returns Holdings may expect from Symphony Icon if Lexicon exercises its Purchase Option. Lexicon had determined it was a variable interest holder of Symphony Icon due to its contribution of the intellectual property relating to the Programs and its issuance of shares of its common stock in exchange for the Purchase Option, which Lexicon intends to exercise if the development of the Programs is successful. Lexicon had determined that it was a primary beneficiary as a result of certain factors, including its primary responsibility for the development of the Programs and its contribution of the intellectual property relating to the Programs. As a result, Lexicon has included the financial condition and results of operations of Symphony Icon in its consolidated financial statements through December 31, 2009. Symphony Icon's cash and cash equivalents have been recorded on Lexicon's consolidated financial statements as short-term investments held by Symphony Icon as of December 31, 2009. The noncontrolling interest in Symphony Icon on Lexicon's consolidated balance sheet initially reflected the \$45 million proceeds contributed into Symphony Icon less \$2.3 million of structuring and legal fees. As the collaboration progressed, this line item was reduced by Symphony Icon's losses, which were \$2.8 million in the three months ended March 31, 2009. The reductions to the noncontrolling interest in Symphony Icon were reflected in Lexicon's consolidated statements of operations using a similar caption and reduced the amount of Lexicon's reported net loss.

Upon the adoption of a new accounting pronouncement regarding variable interest entities (formerly SFAS No. 167) on January 1, 2010, Lexicon determined that it is no longer the primary beneficiary of Symphony Icon. Under the new accounting guidance, neither Lexicon nor Holdings has the power to direct the activities that most significantly impact the economic performance of Symphony Icon; therefore, there is no primary beneficiary. As a result, Lexicon has deconsolidated Symphony Icon as of January 1, 2010, and has not included the financial condition and results of operations of Symphony Icon in its consolidated financial statements as of and for the three months ended March 31, 2010. Symphony Icon had \$5.1 million of total assets and \$3.1 million of total liabilities as of March 31, 2010 based on information provided by Symphony Icon. Lexicon's maximum exposure to loss as a result of its involvement with Symphony Icon is limited to additional funding of \$9.7 million under the Research Cost Sharing, Payment and Extension Agreement as discussed above. Through March 31, 2010, Lexicon has not charged any license fees and has not recorded any revenue from Symphony Icon, and does not expect to do so based on the current agreements with Symphony Icon and Holdings.

## **9. Commitments and Contingencies**

*Operating Lease Obligations:* A Lexicon subsidiary leases laboratory and office space in Hopewell, New Jersey under an agreement which expires in June 2013. The lease provides for two five-year renewal options at 95% of the fair market rent and includes escalating lease payments. Rent expense is recognized on a straight-line basis over the original lease term. Lexicon is the guarantor of the obligations of its subsidiary under this lease. The maximum potential amount of future payments the Company could be required to make under this agreement is \$8.3 million. The Company is required to maintain restricted investments to collateralize a standby letter of credit for this lease. The Company had \$0.4 million in restricted investments as collateral as of March 31, 2010 and December 31, 2009. Additionally, Lexicon leases certain equipment under operating leases.

*Legal Proceedings.* Lexicon is from time to time party to claims and legal proceedings that arise in the normal course of its business and that it believes will not have, individually or in the aggregate, a material adverse effect on its results of operations, financial condition or liquidity.

## **10. Other Capital Stock Agreements**

*Common Stock:* In March 2010, Lexicon completed the public offering and sale and concurrent private placement of an aggregate of 161,770,206 shares of its common stock at a price of \$1.15 per share, resulting in net proceeds of \$181.5 million, after deducting underwriting discounts and commissions of \$4.3 million and offering expenses of \$0.3 million. Invus purchased 94,270,206 of these shares. All of the net proceeds of this offering are reflected as issuance of common stock in the accompanying financial statements.

**11. Collaboration and License Agreements**

Lexicon has derived substantially all of its revenues from drug discovery and development collaborations, target validation collaborations for the development and, in some cases, analysis of the physiological effects of genes altered in knockout mice, government grants and contracts, technology licenses, subscriptions to its databases and compound library sales. Revenues generated from third parties under collaborative arrangements are recorded on a gross basis on the consolidated statements of operations as Lexicon is the principal participant for these transactions for the purpose of accounting for these arrangements.

Lexicon established an alliance with Bristol-Myers Squibb in December 2003 to discover, develop and commercialize small molecule drugs in the neuroscience field. Revenue recognized under this agreement was none and \$0.8 million for the three months ended March 31, 2010 and 2009, respectively.

Lexicon established an alliance with Organon in May 2005 to jointly discover, develop and commercialize novel biotherapeutic drugs. Revenue recognized under this agreement was \$0.2 million and \$1.5 million for the three months ended March 31, 2010 and 2009, respectively.

Lexicon established an alliance with Taconic Farms in November 2005 for the marketing, distribution and licensing of certain lines of knockout mice and entered into an expanded collaboration with Taconic in July 2009. Revenue recognized under these agreements was \$0.7 million and \$0.4 million for the three months ended March 31, 2010 and 2009, respectively.

## Overview

We are a biopharmaceutical company focused on the discovery and development of breakthrough treatments for human disease. We have used our proprietary gene knockout technologies and an integrated platform of advanced medical technologies to identify and validate, in vivo, more than 100 targets with promising profiles for drug discovery. For targets that we believe have high pharmaceutical value, we engage in programs for the discovery and development of potential new drugs, focusing in the core therapeutic areas of immunology, metabolism, cardiology and ophthalmology. Human clinical trials are currently underway for four of our drug candidates, with one additional drug candidate in preclinical development and compounds from a number of additional programs in various stages of preclinical research.

We are working both independently and through strategic collaborations and alliances to capitalize on our technology, drug target discoveries and drug discovery and development programs. Consistent with this approach, we seek to retain exclusive rights to the benefits of certain of our small molecule drug programs by developing drug candidates from such programs internally and to collaborate with third parties with respect to the discovery, development and commercialization of small molecule and biotherapeutic drug candidates for other targets, particularly when the collaboration provides us with access to expertise and resources that we do not possess internally or are complementary to our own. We have established drug discovery and development collaborations with a number of leading pharmaceutical and biotechnology companies which have enabled us to generate near-term cash while offering us the potential to retain economic participation in products our collaborators develop through the collaboration. In addition, we have established collaborations and license agreements with other leading pharmaceutical and biotechnology companies, research institutes and academic institutions under which we received fees and, in some cases, are eligible to receive milestone and royalty payments, in return for granting access to some of our technologies and discoveries.

We derive substantially all of our revenues from drug discovery and development collaborations and other collaborations and technology licenses. To date, we have generated a substantial portion of our revenues from a limited number of sources.

Our operating results and, in particular, our ability to generate additional revenues are dependent on many factors, including our success in establishing new collaborations and technology licenses, expirations of our existing collaborations and alliances, the success rate of our discovery and development efforts leading to opportunities for new collaborations and licenses, as well as milestone payments and royalties, the timing and willingness of collaborators to commercialize products that would result in milestone payments and royalties, and general and industry-specific economic conditions which may affect research and development expenditures. Our future revenues from collaborations and technology licenses are uncertain because our existing agreements have fixed terms or relate to specific projects of limited duration and we depend, in part, on securing new agreements. Our ability to secure future revenue-generating agreements will depend upon our ability to address the needs of our potential future collaborators and licensees, and to negotiate agreements that we believe are in our long-term best interests. We may determine, as we have with our four clinical drug candidates, that our interests are better served by retaining rights to our discoveries and advancing our therapeutic programs to a later stage, which could limit our near-term revenues. Because of these and other factors, our operating results have fluctuated in the past and are likely to do so in the future, and we do not believe that period-to-period comparisons of our operating results are a good indication of our future performance.

Since our inception, we have incurred significant losses and, as of March 31, 2010, we had an accumulated deficit of \$597.7 million. Our losses have resulted principally from costs incurred in research and development, general and administrative costs associated with our operations, and non-cash stock-based compensation expenses associated with stock options and restricted stock granted to employees and consultants. Research and development expenses consist primarily of salaries and related personnel costs, external research costs related to our preclinical and clinical efforts, material costs, facility costs, depreciation on property and equipment and other expenses related to our drug discovery and development programs. General and administrative expenses consist primarily of salaries and related expenses for executive and administrative personnel, professional fees and other corporate expenses including information technology, facilities costs and general legal activities. In connection with the continued expansion of our drug discovery and development programs, we expect to continue to incur significant research and development costs. As a result, we will need to generate significantly higher revenues to achieve profitability.



## Critical Accounting Policies

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make judgments, estimates and assumptions in the preparation of our consolidated financial statements and accompanying notes. Actual results could differ from those estimates. We believe there have been no significant changes in our critical accounting policies as discussed in our Annual Report on Form 10-K for the year ended December 31, 2009.

## Recent Accounting Pronouncements

See Note 4, Recent Accounting Pronouncements, of the Notes to Consolidated Financial Statements, for a discussion of the impact of the new accounting standards on our consolidated financial statements.

## Results of Operations

### Revenues

Total revenues and dollar and percentage changes as compared to the corresponding period in the prior year are as follows (dollar amounts are presented in millions):

	Three Months Ended March 31,	
	2010	2009
Total revenues	\$ 1.6	\$ 4.2
Dollar decrease	\$ (2.5)	
Percentage decrease	(61)%	

- *Collaborative research* – Revenue from collaborative research decreased 54% to \$1.6 million, primarily due to reduced revenues in the three months ended March 31, 2010 under our alliances with N.V. Organon and Bristol-Myers Squibb due to the completion in 2009 of the target discovery portion of these alliances.
- *Subscription and license fees* – Revenue from subscriptions and license fees decreased 100% primarily due to a decrease in technology license fees.

### Research and Development Expenses

Research and development expenses and dollar and percentage changes as compared to the corresponding period in the prior year are as follows (dollar amounts are presented in millions):

	Three Months Ended March 31,	
	2010	2009
Total research and development expense	\$ 21.1	\$ 22.9
Dollar decrease	\$ (1.8)	
Percentage decrease	(8)%	

Research and development expenses consist primarily of salaries and other personnel-related expenses, third-party and other services, facility and equipment costs, laboratory supplies, and stock-based compensation expenses.

- *Personnel* – Personnel costs decreased 23% to \$8.2 million, primarily due to a reduction in our personnel in January 2009 and associated severance costs. Salaries, bonuses, employee benefits, payroll taxes, recruiting and relocation costs are included in personnel costs.
- *Third-party and other services* – Third-party and other services increased 24% to \$6.0 million, primarily due to an increase in external clinical research and development costs.
- *Facilities and equipment* – Facilities and equipment costs decreased 12% to \$3.6 million, primarily due to a decrease in depreciation expense.
- *Laboratory supplies* – Laboratory supplies expense decreased 11% to \$1.5 million, primarily due to reductions in compound acquisitions and genetic research activities.
- *Stock-based compensation* – Stock-based compensation expense was \$0.8 million, consistent with the prior year.
- *Other* – Other costs increased 20% to \$1.0 million.

#### **General and Administrative Expenses**

General and administrative expenses and dollar and percentage changes as compared to the corresponding period in the prior year are as follows (dollar amounts are presented in millions):

	Three Months Ended March 31,	
	2010	2009
Total general and administrative expense	\$ 5.5	\$ 4.9
Dollar increase	\$ 0.6	
Percentage increase	13%	

General and administrative expenses consist primarily of salaries and other personnel-related expenses, professional fees such as legal fees, facility and equipment costs, and stock-based compensation expenses.

- *Personnel* – Personnel costs increased 9% to \$2.7 million. Salaries, bonuses, employee benefits, payroll taxes, recruiting and relocation costs are included in personnel costs.
- *Professional fees* – Professional fees increased 69% to \$1.3 million, primarily due to increased patent-related legal costs.
- *Facilities and equipment* – Facilities and equipment costs decreased 9% to \$0.6 million.
- *Stock-based compensation* – Stock-based compensation expense decreased 19% to \$0.5 million.
- *Other* – Other costs increased 29% to \$0.4 million.

**Gain on Investments, Net, Interest Income, Interest Expense and Other Expense, Net**

*Gain on Investments, Net.* Gain on investments was \$2.2 million for the three months ended March 31, 2010, representing the increase in fair value of our student loan auction rate securities. This gain was offset by a loss on investments of \$2.2 million for the three months ended March 31, 2010, representing the decline in fair value of the rights obtained from UBS AG, the investment bank that sold us our auction rate securities.

*Interest Income.* Interest income decreased 34% to \$0.2 million in the three months ended March 31, 2010 from \$0.3 million in the corresponding period in 2009, due to lower yields on our investments.

*Interest Expense.* Interest expense was \$0.7 million in the three months ended March 31, 2010, consistent with the prior year.

*Other Expense, Net.* Other expense, net decreased 28% to \$0.7 million in the three months ended March 31, 2010 from \$0.9 million in the corresponding period in 2009, primarily due to an impairment in 2009 of surplus equipment as a result of our restructuring.

***Noncontrolling Interest in Symphony Icon, Inc.***

For the three months ended March 31, 2009, the losses attributable to the noncontrolling interest holders of Symphony Icon were \$2.8 million. As discussed in Note 4, Recent Accounting Pronouncements of the Notes to Consolidated Financial Statements, we have determined that upon the adoption of a new accounting pronouncement regarding variable interest entities on January 1, 2010, we are not the primary beneficiary of Symphony Icon, and therefore, we are no longer including the financial condition and results of operations of Symphony Icon in our consolidated financial statements.

***Net Loss Attributable to Lexicon Pharmaceuticals, Inc. and Net Loss Attributable to Lexicon Pharmaceuticals, Inc. per Common Share***

*Net Loss Attributable to Lexicon Pharmaceuticals, Inc. and Net Loss Attributable to Lexicon Pharmaceuticals, Inc. per Common Share.* Net loss attributable to Lexicon Pharmaceuticals, Inc. increased to \$26.1 million in the three months ended March 31, 2010 from \$21.6 million in the corresponding period in 2009. Net loss attributable to Lexicon Pharmaceuticals, Inc. per common share decreased to \$0.13 in the three months ended March 31, 2010 from \$0.16 in the corresponding period in 2009.

Our quarterly operating results have fluctuated in the past and are likely to do so in the future, and we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance.

**Liquidity and Capital Resources**

We have financed our operations from inception primarily through sales of common and preferred stock, contract and milestone payments to us under our drug discovery and development collaborations, target validation, database subscription and technology license agreements, government grants and contracts, and financing obtained under debt and lease arrangements. We have also financed certain of our research and development activities under our agreements with Symphony Icon, Inc. From our inception through March 31, 2010, we had received net proceeds of \$786.9 million from issuances of common and preferred stock. In addition, from our inception through March 31, 2010, we received \$448.8 million in cash payments from drug discovery and development collaborations, target validation, database subscription and technology license agreements, sales of compound libraries and reagents, and government grants and contracts, of which \$436.3 million had been recognized as revenues through March 31, 2010.

As of March 31, 2010, we had \$314.2 million in cash, cash equivalents and investments, including \$53.5 million in auction rate securities and related rights as discussed below under “Disclosure about Market Risk.” As of December 31, 2009, we had \$157.1 million in cash, cash equivalents and investments, including \$56.0 million of auction rate securities and related rights, and \$5.4 million in investments held by Symphony Icon. We used cash of \$21.7 million in operations in the three months ended March 31, 2010. This consisted primarily of the consolidated net loss for the period of \$26.1 million and a net gain on investments and auction rate security rights of \$0.1 million, partially offset by non-cash charges of \$1.4 million related to depreciation expense, \$1.3 million related to stock-based compensation expense, a net decrease in other operating assets net of liabilities of \$1.1 million and \$0.7 million related to the amortization of the Symphony Icon purchase option. Investing activities provided cash of \$2.1 million in the three months ended March 31, 2010, primarily due to maturities of investments of \$2.6 million, partially offset by purchases of property and equipment of \$0.5 million. Financing activities provided cash of \$179.2 million due to net proceeds from issuance of common stock of \$181.5 million, partially offset by net repayment of debt borrowings of \$2.2 million.

*UBS Credit Line.* In January 2009, we entered into a credit line agreement with UBS Bank USA that provides, as of March 31, 2010, up to an aggregate amount of \$35.7 million in the form of an uncommitted, demand, revolving line of credit. We entered into the credit line in connection with our acceptance of an offer from UBS AG, the investment bank that sold us our auction rate securities, providing us with rights to require UBS to purchase our \$53.6 million (par value) of auction rate securities at par value during the period from June 30, 2010 through July 2, 2012. The credit line is secured only by these auction rate securities and advances under the credit line will be made on a “no net cost” basis, meaning that the interest paid by us on advances will not exceed the interest or dividends paid to us by the issuer of the auction rate securities. As of March 31, 2010, we had \$35.5 million outstanding under this credit line.

*Invus Securities Purchase Agreement.* In June 2007, we entered into a securities purchase agreement with Invus, L.P, pursuant to which Invus purchased 50,824,986 shares of our common stock for approximately \$205.4 million in August 2007. Pursuant to the securities purchase agreement, as amended and supplemented, and after accounting for the \$181.5 million net proceeds of our public offering and concurrent private placement of common stock in March 2010, Invus has the right to require us to initiate one pro rata rights offering to our stockholders, which would provide all stockholders with non-transferable rights to acquire shares of our common stock, in an aggregate amount of up to approximately \$163.0 million, less the proceeds of any “qualified offerings” that we may complete in the interim involving the sale of our common stock at prices above \$4.50 per share. We have not completed any such qualified offering. Invus may exercise its right to require us to conduct such a rights offering by giving us notice within a period of one year beginning on February 28, 2011, which will be extended by the number of days during such period that Invus is not permitted under the securities purchase agreement to initiate the rights offering as a result of any “blackout period” in connection with certain public offerings of our common stock. If Invus elects to exercise its right to require us to initiate a rights offering, Invus would be required to purchase its pro rata portion of the offering.

In connection with the securities purchase agreement, we entered into a stockholders’ agreement with Invus under which Invus (a) has specified rights with respect to designation of directors and participation in future equity issuances by us, (b) is subject to certain standstill restrictions, as well as restrictions on transfer and the voting of the shares of common stock held by it and its affiliates, and (c), as long as Invus holds at least 15% of the total number of outstanding shares of our common stock, is entitled to certain minority protections.

*Symphony Drug Development Financing Agreement.* In June 2007, we entered into a series of related agreements providing for the financing of the clinical development of certain of our drug candidates, including LX1031 and LX1032, along with any other pharmaceutical compositions modulating the same targets as those drug candidates. Under the financing arrangement, we licensed to Symphony Icon, a wholly-owned subsidiary of Symphony Icon Holdings LLC, our intellectual property rights related to the programs and Holdings contributed \$45 million to Symphony Icon in order to fund the clinical development of the programs. We also entered into a share purchase agreement with Holdings under which we issued and sold to Holdings 7,650,622 shares of our common stock in exchange for \$15 million and an exclusive option to acquire all of the equity of Symphony Icon, thereby allowing us to reacquire the programs. The purchase option is exercisable by us at any time, in our sole discretion, until June 15, 2011 at an exercise price of (a) \$81 million, if the purchase option is exercised before June 15, 2010 and (b) \$90 million, if the purchase option is exercised on or after June 15, 2010 and before June 15, 2011. The purchase option exercise price may be paid in cash or a combination of cash and common stock, at our sole discretion, provided that the common stock portion may not exceed 40% of the purchase option exercise price.

Upon the recommendation of Symphony Icon's development committee, which is comprised of an equal number of representatives from us and Symphony Icon, Symphony Icon's board of directors may require us to pay Symphony Icon up to \$15 million for Symphony Icon's use in the development of the programs in accordance with the specified development plan and related development budget. The development committee's right to recommend that Symphony Icon's board of directors submit such funding requirement to us will terminate on the one-year anniversary of the expiration of the purchase option, subject to limited exceptions. Through March 2010, Symphony Icon's board of directors has requested us to pay Symphony Icon \$5.3 million under this agreement, all which has been paid through March 31, 2010, and we expect that additional funding will be needed in the future.

*Facilities.* In April 2004, we obtained a \$34.0 million mortgage on our facilities in The Woodlands, Texas. The mortgage loan has a ten-year term with a 20 year amortization and bears interest at a fixed rate of 8.23%. The mortgage had a principal balance outstanding of \$29.3 million as of March 31, 2010. In May 2002, our subsidiary Lexicon Pharmaceuticals (New Jersey), Inc. leased a 76,000 square-foot laboratory and office space in Hopewell, New Jersey. The term of the lease extends until June 30, 2013. The lease provides for an escalating yearly base rent payment of \$1.3 million in the first year, \$2.1 million in years two and three, \$2.2 million in years four to six, \$2.3 million in years seven to nine and \$2.4 million in years ten and eleven. We are the guarantor of the obligations of our subsidiary under the lease.

Our future capital requirements will be substantial and will depend on many factors, including our ability to obtain drug discovery and development collaborations and other collaborations and technology license agreements, the amount and timing of payments under such agreements, the level and timing of our research and development expenditures, market acceptance of our products, the resources we devote to developing and supporting our products and other factors. Our capital requirements will also be affected by any expenditures we make in connection with license agreements and acquisitions of and investments in complementary technologies and businesses. We expect to devote substantial capital resources to continue our research and development efforts, to expand our support and product development activities, and for other general corporate activities. We believe that our current unrestricted cash and investment balances and cash and revenues we expect to derive from drug discovery and development collaborations and other collaborations and technology licenses will be sufficient to fund our operations for at least the next 12 months. During or after this period, if cash generated by operations is insufficient to satisfy our liquidity requirements, we will need to sell additional equity or debt securities or obtain additional credit arrangements. Additional financing may not be available on terms acceptable to us or at all. The sale of additional equity or convertible debt securities may result in additional dilution to our stockholders.

**Disclosure about Market Risk**

We are exposed to limited market and credit risk on our cash equivalents which have maturities of three months or less at the time of purchase. We maintain a short-term investment portfolio which consists of U.S. Treasury bills, money market accounts and certificates of deposit that mature three to 12 months from the time of purchase and auction rate securities that mature greater than 12 months from the time of purchase, which we believe are subject to limited market and credit risk, other than as discussed below. We currently do not hedge interest rate exposure or hold any derivative financial instruments in our investment portfolio.

At March 31, 2010, we held \$53.6 million (par value), with an estimated fair value of \$46.0 million, of investments with an auction interest rate reset feature, known as auction rate securities. These notes are issued by various state agencies for the purpose of financing student loans. The securities have historically traded at par and are redeemable at par plus accrued interest at the option of the issuer. Interest is typically paid at the end of each auction period or semiannually. Until February 2008, the market for our auction rate securities was highly liquid. Starting in February 2008, a substantial number of auctions “failed,” meaning that there was not enough demand to sell all of the securities that holders desired to sell at auction. The immediate effect of a failed auction is that such holders cannot sell the securities at auction and the interest rate on the security generally resets to a maximum interest rate. In the case of funds invested by us in auction rate securities which are the subject of a failed auction, we may not be able to access the funds without a loss of principal, unless a future auction on these investments is successful or the issuer redeems the security. We have modified our current investment strategy to reallocate our investments more into U.S. treasury securities and U.S. treasury-backed money market investments.

At March 31, 2010, observable auction rate securities market information was not available to determine the fair value of our investments. We have estimated the fair value of these securities at \$46.0 million as of March 31, 2010 using models of the expected future cash flows related to the securities and taking into account assumptions about the cash flows of the underlying student loans, as well as secondary market data. The assumptions used in preparing the discounted cash flow model include estimates of interest rates, timing and amount of cash flows, liquidity premiums and expected holding periods of the auction rate securities, based on data available as of March 31, 2010. The underlying sources of these assumptions are volatile and the assumptions are subject to change as those sources and market conditions change.

In November 2008, we accepted an offer from UBS AG, the investment bank that sold us our auction rate securities, providing us with rights related to our auction rate securities. The rights permit us to require UBS to purchase our \$53.6 million (par value) of auction rate securities at par value during the period from June 30, 2010 through July 2, 2012. Conversely, UBS has the right, in its discretion, to purchase or sell the securities at any time by paying us the par value of such securities. We expect to exercise the rights and sell our auction rate securities back to UBS on June 30, 2010, the earliest date allowable under the rights.

The enforceability of the rights results in a separate asset that will be measured at its fair value. We elected to measure the rights under a fair value option, which permits entities to choose, at certain election dates, to measure eligible items at fair value. As a result of accepting the rights, we have elected to classify the rights and reclassify our investments in auction rate securities as trading securities from available-for-sale securities. As a result, we will assess the fair value of these two individual assets and record changes each period until the rights are exercised and the auction rate securities are redeemed. We expect that subsequent changes in the value of the rights will largely offset the subsequent fair value movements of the auction rate securities, subject to the continued expected performance by the investment bank of its obligations under the agreement.

Excluding auction rate securities and the ARS Rights, at March 31, 2010, we had approximately \$260.6 million in cash and cash equivalents and short-term investments. We believe that the working capital available to us excluding the funds held in auction rate securities will be sufficient to meet our cash requirements for at least the next 12 months.

We have operated primarily in the United States and substantially all sales to date have been made in U.S. dollars. Accordingly, we have not had any material exposure to foreign currency rate fluctuations.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

See “Disclosure about Market Risk” under “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations” for quantitative and qualitative disclosures about market risk.

**Item 4. Controls and Procedures**

Our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective to ensure that the information required to be disclosed by us in the reports we file under the Securities Exchange Act is gathered, analyzed and disclosed with adequate timeliness, accuracy and completeness, based on an evaluation of such controls and procedures as of the end of the period covered by this report.

Subsequent to our evaluation, there were no significant changes in internal controls or other factors that could significantly affect internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

## Part II Other Information

### Item 1. Legal Proceedings

We are from time to time party to claims and legal proceedings that arise in the normal course of our business and that we believe will not have, individually or in the aggregate, a material adverse effect on our results of operations, financial condition or liquidity.

### Item 1A. Risk Factors

The following risks and uncertainties are important factors that could cause actual results or events to differ materially from those indicated by forward-looking statements. The factors described below are not the only ones we face and additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations.

#### *Risks Related to Our Need for Additional Financing and Our Financial Results*

- We will need additional capital in the future and, if it is unavailable, we will be forced to significantly curtail or cease our operations. If it is not available on reasonable terms, we will be forced to obtain funds by entering into financing agreements on unattractive terms.
- We have a history of net losses, and we expect to continue to incur net losses and may not achieve or maintain profitability.
- We have licensed the intellectual property, including commercialization rights, to our drug candidates LX1031 and LX1032 to Symphony Icon and will not receive any future royalties or revenues with respect to these drug candidates unless we exercise our option to purchase Symphony Icon.
- At March 31, 2010, we held \$53.6 million (par value), with an estimated fair value of \$46.0 million, of auction rate securities for which auctions have failed and, as a result, we may not be able to access at least a portion of these funds without a loss of principal.
- Our operating results have been and likely will continue to fluctuate, and we believe that period-to-period comparisons of our operating results are not a good indication of our future performance.

#### *Risks Related to Discovery and Development of Our Drug Candidates*

- We are an early-stage company, and have not proven our ability to successfully develop and commercialize drug candidates based on our drug target discoveries.
- Clinical testing of our drug candidates in humans is an inherently risky and time-consuming process that may fail to demonstrate safety and efficacy, which could result in the delay, limitation or prevention of regulatory approval.

#### *Risks Related to Regulatory Approval of Our Drug Candidates*

- Our drug candidates are subject to a lengthy and uncertain regulatory process that may not result in the necessary regulatory approvals, which could adversely affect our ability to commercialize products.
- If our potential products receive regulatory approval, we or our collaborators will remain subject to extensive and rigorous ongoing regulation.



*Risks Related to Commercialization of Products*

- The commercial success of any products that we may develop will depend upon the degree of market acceptance of our products among physicians, patients, health care payors, private health insurers and the medical community.
- If we are unable to establish sales and marketing capabilities or enter into agreements with third parties to market and sell our drug candidates, we may be unable to generate product revenues.
- If we are unable to obtain adequate coverage and reimbursement from third-party payors for any products that we may develop, our revenues and prospects for profitability will suffer.
- Our competitors may develop products that make our products obsolete.
- We may not be able to manufacture our drug candidates in commercial quantities, which would prevent us from commercializing our drug candidates.

*Risks Related to Our Relationships with Third Parties*

- Disagreements with Symphony Icon regarding the development of our drug candidates LX1031 or LX1032 could negatively affect or delay their development.
- We are dependent in many ways upon our collaborations with major pharmaceutical companies. The revenues we receive under our existing collaborations have been decreasing in recent periods and are likely to continue to decrease in the future. If we are unable to achieve milestones under our collaborations or if our collaborators' efforts fail to yield pharmaceutical products on a timely basis, our opportunities to generate revenues and earn royalties will be reduced.
- Conflicts with our collaborators could jeopardize the success of our collaborative agreements and harm our product development efforts.
- We rely on third parties to carry out drug development activities.
- We lack the capability to manufacture materials for preclinical studies, clinical trials or commercial sales and rely on third parties to manufacture our drug candidates, which may harm or delay our product development and commercialization efforts.

*Risks Related to Our Intellectual Property*

- If we are unable to adequately protect our intellectual property, third parties may be able to use our technology, which could adversely affect our ability to compete in the market.
- We may be involved in patent litigation and other disputes regarding intellectual property rights and may require licenses from third parties for our discovery and development and planned commercialization activities. We may not prevail in any such litigation or other dispute or be able to obtain required licenses.
- We use intellectual property that we license from third parties. If we do not comply with these licenses, we could lose our rights under them.
- We have not sought patent protection outside of the United States for some of our inventions, and some of our licensed patents only provide coverage in the United States. As a result, our international competitors could be granted foreign patent protection with respect to our discoveries.

- We may be subject to damages resulting from claims that we, our employees or independent contractors have wrongfully used or disclosed alleged trade secrets of their former employers.

*Risks Related to Employees, Growth and Facilities Operations*

- The loss of key personnel or the inability to attract and retain additional personnel could impair our ability to expand our operations.
- Our collaborations with outside scientists may be subject to restriction and change.
- Security breaches may disrupt our operations and harm our operating results.
- Because most of our operations are located at a single facility, the occurrence of a disaster could significantly disrupt our business.

*Risks Related to Environmental and Product Liability*

- We use hazardous chemicals and radioactive and biological materials in our business. Any claims relating to improper handling, storage or disposal of these materials could be time consuming and costly.
- We may be sued for product liability.

*Risks Related to Our Common Stock*

- Our stock price may be extremely volatile.
- Invus' ownership of our common stock and its other rights under our stockholders' agreement we entered into in connection with Invus' \$205.4 million initial investment in our common stock provide Invus with substantial influence over matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, as well as other corporate matters.
- We may engage in future acquisitions, which may be expensive and time consuming and from which we may not realize anticipated benefits.
- Future sales of our common stock may depress our stock price.
- If we are unable to meet Nasdaq continued listing requirements, Nasdaq may take action to delist our common stock.

For additional discussion of the risks and uncertainties that affect our business, see "Item 1A. Risk Factors" included in our annual report on Form 10-K for the year ended December 31, 2009, as filed with the Securities and Exchange Commission.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table provides information about our purchases of shares of our common stock during the three months ended March 31, 2010:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program	Maximum Number of Shares that May Yet be Purchased Under the Program <sup>(1)</sup>
January 1 – 31, 2010	—	\$ —	—	\$ —
February 1 – 28, 2010	77,892 <sup>(2)</sup>	\$ 1.91 <sup>(3)</sup>	—	\$ —
March 1 – 31, 2010	—	\$ —	—	\$ —

<sup>(1)</sup> In connection with the vesting of restricted stock bonus awards granted under our Equity Incentive Plan, which was adopted in February 2009 as an amendment and restatement of our 2000 Equity Incentive Plan and expires in February 2019, certain recipients of such restricted stock bonus awards elected to satisfy their withholding tax obligations with respect to such vesting event by having us retain a portion of the vested shares. In the future, we may grant additional restricted equity securities under our Equity Incentive Plan for which the recipient's tax withholding obligations may be satisfied by our retention of a portion of such securities. Further, the number of such restricted equity securities which may vest will be dependent on the continued employment of such recipients or other performance-based conditions. As a result, we cannot predict with any certainty either the total amount of restricted equity securities or the approximate dollar value of such securities that we may purchase in future years as those securities vest.

<sup>(2)</sup> Represents shares retained by us at the election of certain recipients of restricted stock bonus awards granted under our Equity Incentive Plan in satisfaction of their withholding tax obligations with respect to the vesting of those awards.

<sup>(3)</sup> Represents the market price of our common stock on the date of vesting, calculated in accordance with the process for determination of fair market value under our Equity Incentive Plan.

**Item 6. Exhibits**

<u>Exhibit No.</u>	<u>Description</u>
†10.1	— Collaboration and License Agreement, dated February 16, 2010, with N.V. Organon and its affiliates Intervet Inc. and Schering Corporation, acting through its Schering-Plough Research Institute division
31.1	— Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	— Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	— Certification of Principal Executive and Principal Financial Officers Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

† Confidential treatment has been requested for a portion of this exhibit. The confidential portions of this exhibit have been omitted and filed separately with the Securities and Exchange Commission.

**Signatures**

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

**Lexicon Pharmaceuticals, Inc.**

Date: May 7, 2010

By: /s/ Arthur T. Sands  
Arthur T. Sands, M.D., Ph.D.  
*President and Chief Executive Officer*

Date: May 7, 2010

By: /s/ James F. Tessmer  
James F. Tessmer  
*Vice President, Finance and Accounting*

**Index to Exhibits**

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Confidential materials omitted and filed separately with the Securities and Exchange Commission. Asterisks denote omissions.

## COLLABORATION AND LICENSE AGREEMENT

THIS COLLABORATION AND LICENSE AGREEMENT (this "Agreement") is dated as of February 16, 2010 (the "Effective Date") and is made by and among LEXICON PHARMACEUTICALS, INC. (formerly known as Lexicon Genetics Incorporated), a corporation organized under the laws of the State of Delaware ("Lexicon"); N.V. ORGANON, a registered company organized under the laws of the Netherlands ("Organon") and its Affiliates SCHERING CORPORATION, a corporation organized under the laws of the State of New Jersey, acting through its Schering-Plough Research Institute division ("SPRI") and INTERVET INC., a corporation organized under the laws of the State of Delaware ("Intervet") (Organon, SPRI and Intervet hereinafter collectively referred to as "Schering-Plough"). Lexicon and Schering-Plough are sometimes referred to herein individually as a "party" and collectively as the "parties."

## RECITALS

WHEREAS, Lexicon, Organon and Intervet entered into a Collaboration and License Agreement dated as of May 16, 2005 (the "Predecessor Agreement Effective Date") relating to the discovery and development of antibody and protein therapeutics for selected gene and protein targets (the "Predecessor Agreement");

WHEREAS, Schering-Plough Corporation, SPRI's parent company, acquired the pharmaceutical business of Akzo Nobel N.V., including ownership of Organon and Intervet, effective November 19, 2007 (the "Acquisition Effective Date"); and

WHEREAS, the parties desire to establish a new agreement in replacement of the Predecessor Agreement;

NOW, THEREFORE, in consideration of the premises and of the covenants herein contained, the parties hereto mutually agree as follows:

## ARTICLE 1. DEFINITIONS

For purposes of this Agreement, the terms defined in this Article 1 shall have the respective meanings specified below:

1.1 "Affiliate" means any corporation, company, partnership, joint venture or firm that controls, is controlled by or is under common control with a party to this Agreement. For purposes hereof, "control" means (a) in the case of a corporate entity, direct or indirect ownership of more than fifty percent (50%) of the stock or shares entitled to vote for the election of directors or the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of an entity, whether through ownership of voting securities, by contract or otherwise; and (b) in the case of a non-corporate entity, direct or indirect ownership of more than fifty percent (50%) of the equity interests with the power to direct the management and policies of such non-corporate entity.

1.2 "Agreement" has the meaning specified in the initial paragraph hereof.

1.3 "Antibody" means a composition comprising a whole antibody, or any fragment thereof.

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1.4 “Antisense Compound” means a composition comprising an oligonucleotide or oligonucleotide analog, whether single or double-stranded, including, without limitation, an siRNA, that hybridizes to a selected mRNA or otherwise interferes with translation or transcription of such mRNA.

1.5 “Acquisition Effective Date” has the meaning specified in the recitals of this Agreement.

1.6 “Background Materials” means Lexicon Background Materials and Schering-Plough Background Materials.

1.7 “Background Technology” means Lexicon Background Technology and Schering-Plough Background Technology.

1.8 “BLA” means a Biologics License Application (as defined in the FDC Act) filed with the FDA and any other equivalent marketing authorization application or other license, registration or other application seeking approval from a Regulatory Authority to market a Collaboration Product in the Field in any country or region within the Territory.

1.9 “Biotherapeutics Research” means the conduct of activities relating to the generation of Antibodies, Antisense Compounds and Proteins relating to Program Targets that have not become Released Targets or Reverted Targets and the identification, characterization, selection, optimization and research of Program Antibodies, Program Antisense Compounds and Program Proteins prior to their designation as Collaboration Products. Biotherapeutics Research may include, without limitation, (a) the expression of Proteins comprising Program Targets, (b) the generation of Program Antibodies, (c) the generation of Program Antisense Compounds, (d) the development of assays for Program Antibodies, Program Antisense Compounds and Program Proteins to, *inter alia*, confirm the activity of such Program Antibodies, Program Antisense Compounds or Program Proteins, and (e) the optimization of such Program Antibodies, Program Antisense Compounds or Program Proteins, as the case may be, in each case with the objective of identifying Program Antibodies, Program Antisense Compounds and Program Proteins that are suitable for Development and meet the criteria required for designation as Collaboration Products.

1.10 “Biotherapeutics Research Plan” means and includes any Biotherapeutics Research Plan under the Predecessor Agreement and the plan to be developed by the Joint Research Committee and approved by the Joint Management Committee for each Contract Year in accordance with Section 5.2 hereof.

1.11 “Biotherapeutics Research Program Costs” means costs and expenses that are incurred after the Effective Date by Lexicon or its Affiliates in performing Biotherapeutics Research activities in accordance with an applicable Biotherapeutics Research Plan and its associated budget approved by the Joint Management Committee, including:

(a) the costs of internal scientific, medical, technical and managerial personnel engaged in Biotherapeutics Research activities (together with all associated laboratory supplies, facilities and occupancy costs), which costs shall be determined based on FTE Costs, unless another basis is otherwise agreed upon by the parties in writing;

(b) out-of-pocket expenditures directly related to such Biotherapeutics Research activities, including payments to contract research organizations, consultants and other subcontractors, subject to Section 2.2.4; and

(c) any other costs expressly provided for and actually incurred in accordance with such Biotherapeutics Research Plan.

1.12 “Collaboration” means the program described in the Predecessor Agreement and this Agreement in which the parties have collaborated and will continue to collaborate, in each case, to identify, characterize and carry out the Biotherapeutics Research, Development and Commercialization under the Predecessor Agreement, and the Biotherapeutics Research under this Agreement, of Antibodies (and, if appropriate, Antisense Compounds) that act through, and Proteins that are encoded by, Program Targets that have not become Released Targets or Reverted Targets for use in the Field. For clarity, the Collaboration shall be deemed to include all activities conducted by the parties and their respective Affiliates during the Collaboration Term relating to the identification, characterization and carrying out the Biotherapeutics Research of Antibodies (and, if appropriate, Antisense Compounds) that act through, and Proteins that are encoded by, Program Targets that have not (at the time such activities are conducted) become Released Targets or Reverted Targets, including any such activities that may be conducted independent of the other party or outside the scope of a Biotherapeutics Research Plan.

1.13 “Collaboration Committee” means the Joint Management Committee or Joint Research Committee.

1.14 “Collaboration Product” means a Program Antibody, Program Antisense Compound or Program Protein that has been selected for Development by Schering-Plough in accordance with Section 6.2 hereof that has not become a Released Product or a Reverted Product.

1.15 “Collaboration Term” has the meaning specified in Section 2.1.2 hereof.

1.16 “Commercialization” or “Commercialize” means any and all activities associated with marketing, promoting, distributing, importing, exporting or selling a Collaboration Product in the Field.

1.17 “Confidential Information” means any proprietary information and data received by a party or its Affiliates (the “Receiving Party”) from the other party or its Affiliates (the “Disclosing Party”) in connection with the Predecessor Agreement or this Agreement (including, without limitation, any research, testing, clinical, regulatory, marketing or other scientific or business information, plans, or data pertaining to any Collaboration Product of the Disclosing Party). Notwithstanding the foregoing, Confidential Information shall not include any part of such information or data that:

(a) is or becomes part of the public domain other than by unauthorized acts of the Receiving Party or its Affiliates;

(b) can be shown by written documents to have been already in the possession of the Receiving Party or its Affiliates prior to its first disclosure under the Predecessor Agreement or this Agreement, *provided* such Confidential Information was not obtained directly or indirectly from the Disclosing Party under an obligation of confidentiality;

(c) can be shown by written documents to have been disclosed to the Receiving Party or its Affiliates by a Third Party, *provided* such Confidential Information was not obtained directly or indirectly from the Disclosing Party under an obligation of confidentiality; or

(d) can be shown by written documents to have been independently developed by the Receiving Party or its Affiliates without the aid, use or application of Confidential Information of the Disclosing Party.



Any combination of features or disclosures shall not be deemed to fall within the foregoing exclusions merely because individual features are published or available in the public domain or in the rightful possession of the Receiving Party unless the combination itself is published or is available in the public domain or in the rightful possession of the Receiving Party.

1.18 “Contract Year” means (a) with respect to the first Contract Year, the period beginning on the Effective Date and ending on December 31, 2009 (the “First Contract Year”), and (b) with respect to each subsequent Contract Year, the twelve (12) month period beginning on the day following the end of the First Contract Year and each succeeding twelve (12) month period thereafter. Each Contract Year (other than the First and last Contract Year, as applicable) shall be divided into four (4) “Contract Quarters” comprised of successive three (3) month periods. In the First Contract Year, the first Contract Quarter shall begin on the Effective Date and end on December 31, 2009.

1.19 “Control” or “Controlled” means, with respect to any (a) material, document, item of information, method, data or other know-how or (b) Patent Right or other intellectual property right, the possession (whether by ownership or license, other than by a license granted pursuant to this Agreement) by a party or its Affiliates of the ability to grant to the other party access, ownership, a license or a sublicense as provided herein under such item or right without violating the terms of any agreement or other arrangement with any Third Party as of the time such party would first be required hereunder to grant the other party such access, ownership, license or sublicense.

1.20 “Cover,” “Covered” or “Covering” means, with respect to a Patent Right, that, but for rights granted to a person or entity under such Patent Right, the practice by such person or entity of an invention claimed in such Patent Right would infringe a Valid Claim included in such Patent Right, or in the case of a Patent Right that is a patent application, would infringe a claim in such patent application if it were to issue as a patent.

1.21 “Development” or “Develop” means the conduct of all tests, clinical and other studies and other activities (including test method development, toxicology studies, statistical analysis and report writing, preclinical and other testing, packaging and regulatory affairs, product approval and registration activities), including such tests, studies and other activities as may be required or recommended from time to time by any Regulatory Authority to obtain, maintain or expand Regulatory Approval of a Collaboration Product or Reverted Product in the Field.

1.22 “Diligent Efforts” means the carrying out of obligations or tasks by a party (or, as applicable, its Affiliates or (sub)licensee(s)) using good faith commercially reasonable efforts, which efforts shall be consistent with the exercise of prudent scientific and business judgment in accordance with the efforts such party devotes to products or research, development or marketing projects of similar scientific and commercial potential. For the avoidance of doubt, matters or events beyond the reasonable control of a party, such as delays or actions taken by a Regulatory Authority, that result in delays in a research program shall not constitute a lack of diligence hereunder.

1.23 “Disclosing Party” has the meaning specified in Section 1.17 hereof.

1.24 “Effective Date” means the date specified in the initial paragraph of this Agreement.

1.25 “EMEA” means the European Medicines Agency, or any successor thereto.

1.26 “Event of Default” means an event described in Section 15.2 hereof.

1.27 “FDA” means the United States Food and Drug Administration, or any successor thereto.

- 1.28 “FDC Act” means the United States Food, Drug and Cosmetic Act (or any successor thereto), as amended, and the rules and regulations promulgated thereunder.
- 1.29 “Field” means the diagnosis, prevention, control and treatment in humans or animals of any disease or condition.
- 1.30 “First Commercial Sale” means, with respect to a country in the Territory, the first [\*\*] by Schering-Plough or any of its Affiliates or (sub)licensees (or, in the case of a Reverted Product, by Lexicon or any of its Affiliates or (sub)licensees) for use in the Field after the receipt of Regulatory Approval in such country. Sales for test marketing, sampling and promotional uses, clinical trial purposes or compassionate or similar use shall not be considered to constitute a First Commercial Sale.
- 1.31 “FTE” means a full-time-equivalent person-year of scientific, technical or managerial work on or directly related to Target Function Discovery Program or Biotherapeutics Research activities, as applicable, calculated on the basis of [\*\*].
- 1.32 “FTE Costs” means the amounts (which amounts include salaries, fringe benefits, overtime and all other costs of employing FTEs, including overhead such as laboratory supplies, facilities and occupancy costs) determined by multiplying (a) the number of FTEs allocated by Lexicon during the relevant time period, subject to any limitations set forth in the applicable Biotherapeutics Research Plan or otherwise established by the Joint Management Committee, by (b) the applicable FTE Rate(s).
- 1.33 “FTE Rate” means the agreed-upon cost per FTE, which shall be adjusted annually (beginning in January 2010) by the percentage increase or decrease in the U.S. Producer Price Index for Total Manufacturing Industries (PCUOMFG#) as of the then most recent December 31 over the level of the PCUOMFG# as of the December 31 of the previous year. Such adjustments shall be the responsibility of the Joint Management Committee. The initial FTE Rate is [\*\*] on a per annum basis.
- 1.34 “GAAP” means United States generally accepted accounting principles, as they exist from time to time, consistently applied.
- 1.35 “IND” means an Investigational New Drug application filed with the FDA or a similar application for the clinical testing of a Collaboration Product in human subjects filed with a foreign Regulatory Authority.
- 1.36 “Joint Management Committee” has the meaning specified in Section 3.1.1 hereof.
- 1.37 “Joint Research Committee” has the meaning specified in Section 3.1.2 hereof.
- 1.38 “Joint Research Project Team” has the meaning specified in Section 3.1.2 hereof.
- 1.39 “Laws” means all laws, statutes, rules, regulations, ordinances and other pronouncements having the effect of law of any federal, national, multinational, state, provincial, county, city or other political subdivision, domestic or foreign.
- 1.40 “Level 1 Phenotypic Analysis” means the analyses of the phenotypes of Mutant Mice described in Exhibit 1.40.
- 1.41 “Level 2 Phenotypic Analysis” means any one or more of the analyses of the phenotypes of Mutant Mice described in Exhibit 1.41.

1.42 “Lexicon Background Materials” means any Antibodies, Antisense Compounds, Proteins, Mutant Mice, reagents, assays or other materials that are (a) necessary or reasonably useful for the conduct of the Collaboration, (b) Controlled by Lexicon, (c) utilized in the Collaboration (but only to the extent so utilized) and (d) either in Lexicon’s or any of its Affiliates’ possession as of the Predecessor Agreement Effective Date or discovered or acquired by Lexicon or any of its Affiliates during the Collaboration Term but outside of the conduct of the Collaboration. Lexicon Background Materials excludes Program Targets and Program Materials.

1.43 “Lexicon Background Technology” means any inventions, information, methods, know-how, trade secrets or data that (a) are necessary or reasonably useful for the performance of the Collaboration, (b) are Controlled by Lexicon, (c) are utilized in the Collaboration (but only to the extent so utilized) and (d) either are in Lexicon’s or any of its Affiliates’ possession as of the Predecessor Agreement Effective Date or are discovered or acquired by Lexicon or any of its Affiliates during the Collaboration Term but outside of the conduct of the Collaboration. Lexicon Background Technology includes any inventions, information, method, know-how, trade secrets or data, other than Program Technology, that are first identified or discovered in the conduct of the Target Function Discovery Program (excluding, for clarity, any inventions, information, method, know-how, trade secrets or data relating to Small Molecule Compounds or uses thereof, including, without limitation, Small Molecule Compounds acting through Program Targets). Lexicon Background Technology also includes any inventions, information, methods, know-how, trade secrets or data relating to research and development methods and processes first identified or discovered by Lexicon or its Affiliates in the course of performing Biotherapeutics Research activities under the Collaboration, in each case that are not Program Technology.

1.44 “Major Market” means (a) the United States, (b) Japan, and (c) the European Union (under the centralized process) or any combination of three of the following five countries: Germany, the United Kingdom, France, Italy and Spain.

1.45 “Mutant Mouse” means a mouse cell or mouse containing a selected mutation in the murine ortholog of a Program Target that is made or produced by Lexicon. A “line of Mutant Mice” means Mutant Mice having the same selected mutation.

1.46 “Net Sales” means the aggregate gross amount invoiced by Schering-Plough and its Affiliates and (sub)licensees on all sales of Collaboration Products (or by Lexicon and its Affiliates and (sub)licensees on all sales of Reverted Products) in the Territory to a Third Party, less the following deductions from such gross amounts:

- (a) bad debts actually written off which are directly attributable or allocable to sales of the Collaboration Product or Reverted Product;
- (b) credits or allowances for damaged goods, returns or rejections or recalls of Collaboration Product or Reverted Product and shelf stock and other retroactive price adjustments actually granted;
- (c) normal and customary trade, cash, quantity and volume based discounts, allowances and credits actually given;
- (d) sales or similar taxes (other than income taxes);
- (e) freight, postage, shipping and insurance charges actually allowed or paid; and

(f) chargebacks and rebates actually paid to managed healthcare organizations or to federal, state and local governments, their agencies, or to trade customers, including without limitation, wholesalers, hospital buying groups and chain pharmacy buying groups.

Such amounts shall be determined from the books and records of Schering-Plough and its Affiliates and (sub)licensees (or, in the case of Reverted Products, Lexicon and its Affiliates and (sub)licensees), as the case may be, maintained in accordance with GAAP.

In the event the Collaboration Product or Reverted Product is sold as part of a Combination Product (as defined below), the Net Sales from the Combination Product, for the purposes of determining royalty payments, will be determined by multiplying the Net Sales of the Combination Product by the fraction,  $A/A+B$  where A is the average sale price of such Collaboration Product or Reverted Product when sold separately in finished form and B is the average sale price of the other active compounds or ingredients in the Combination Product sold separately in finished form.

In the event that the average sale price of the Collaboration Product or Reverted Product can be determined but the average sale price of the other active compounds or ingredients cannot be determined, Net Sales for purposes of determining royalty payments will be calculated by multiplying the Net Sales of the Combination Product by the fraction  $C/C+D$  where C is the selling party's average sales price of the Collaboration Product or Reverted Product and D is the difference between the average selling price of the Combination Product and the average selling price of the Collaboration Product or Reverted Product. If the average sale price of the other active compounds or ingredients can be determined but the average price of the Collaboration Product or Reverted Product cannot be determined, Net Sales for purposes of determining royalty payments will be calculated by multiplying the Net Sales of the Combination Product by the following formula: one minus  $C/C+D$  where C is the average selling price of the other product(s) and D is the difference between the average selling price of the Combination Product and the average selling price of the other active compounds or ingredients.

In the event that the average sales price of both the Collaboration Product or Reverted Product and the other active compounds or ingredients in the Combination Product cannot be determined, the Net Sales of the Collaboration Product or Reverted Product shall be negotiated in good faith by the parties.

The Net Sales price for a Combination Product in a given country will be calculated once each Contract Year and such price will be used during all applicable royalty reporting periods for the entire Contract Year for such country, absent extraordinary conditions or events. When determining the average sale price of a Collaboration Product or Reverted Product or the other active compounds or ingredients in the Combination Product, the average sale price will be calculated using data arising from the twelve (12) months preceding the calculation of the Net Sales price for the Combination Product. As used above, the term "Combination Product" means any Collaboration Product or Reverted Product sold in conjunction with any other active component(s) (whether packaged together or in the same therapeutic formulation).

Free samples of Collaboration Product or Reverted Product and the disposition of Collaboration Product or Reverted Product for, or the use of Collaboration Product or Reverted Product in, human clinical trials in which such Collaboration Product or Reverted Product is provided to patients without any payment shall not result in any Net Sales.

1.47 "Patent Prosecution" has the meaning specified in Section 11.2.1 hereof.

1.48 "Patent Rights" means all existing patents and patent applications and all patent applications hereafter filed and patents hereafter issued, including, without limitation, any continuations, continuations-in-part, divisions, provisionals or any substitute applications, any patent issued with respect to any such patent applications, any reissue, reexamination, renewal or extension (including any supplemental protection certificate) of any such patent, and any confirmation patent or registration patent or patent of addition based on any such patent, and all foreign counterparts of any of the foregoing.

1.49 “Phase 1 Clinical Trial” means a human clinical trial in any country that is intended to initially evaluate the safety or pharmacological effect of a Collaboration Product in subjects or that would otherwise satisfy requirements of 21 CFR 312.21(a), or its foreign equivalent. For purposes of this Agreement, “Commencement of a Phase 1 Clinical Trial” for a Collaboration Product means the first introduction of such Collaboration Product into a human patient in a Phase 1 Clinical Trial.

1.50 “Phase 2 Clinical Trial” means a human clinical trial in any country that is intended to initially evaluate the effectiveness of a Collaboration Product for a particular indication or indications in patients with the disease or indication under study or that would otherwise satisfy requirements of 21 CFR 312.21(b), or its foreign equivalent. For purposes of this Agreement, “Commencement of a Phase 2 Clinical Trial” for a Collaboration Product means the first introduction of such Collaboration Product into a human patient in a Phase 2 Clinical Trial.

1.51 “Phase 3 Clinical Trial” means a pivotal human clinical trial in any country the results of which could be used to establish safety and efficacy of a Collaboration Product as a basis for a BLA or that would otherwise satisfy the requirements of 21 CFR 312.21(c) or its foreign equivalent. For purposes of this Agreement, “Commencement of a Phase 3 Clinical Trial” for a Collaboration Product means the first introduction of such Collaboration Product into a human patient in a Phase 3 Clinical Trial.

1.52 “Post-Approval Study” means a human clinical trial conducted after Regulatory Approval of the applicable Collaboration Product for the applicable indication has been obtained in the relevant country.

1.53 “Predecessor Agreement” has the meaning specified in the recitals of this Agreement.

1.54 “Predecessor Agreement Effective Date” has the meaning specified in the recitals of this Agreement.

1.55 “Program Director” has the meaning specified in Section 3.2 hereof.

1.56 “Program Antibody” means an Antibody that: (a) (i) is selected by the Joint Research Committee for research, optimization or preclinical evaluation in the conduct of the Collaboration, (ii) is Controlled by a party, and (iii) binds to or otherwise modulates a Program Target; (b) is first [\*\*] in the conduct of the Collaboration; (c) binds to or otherwise modulates a Program Target and is first identified or discovered by Schering-Plough or its Affiliates after Schering-Plough’s selection for Development of a Collaboration Product for such Program Target and prior to the earlier of (i) the time that such Program Target has become a Released Target or Reverted Target and (ii) the expiration or earlier termination of this Agreement with respect to such Collaboration Product pursuant to Article 15 hereof; or (d) is otherwise designated a Program Antibody by the Joint Management Committee.

1.57 “Program Antisense Compound” means an Antisense Compound that: (a)(i) is selected by the Joint Research Committee for research, optimization or preclinical evaluation in the conduct of the Collaboration, (ii) is Controlled by a party, and (iii) binds to or otherwise modulates a Program Target; (b) is first [\*\*] in the conduct of the Collaboration; (c) binds to or otherwise modulates a Program Target and is first identified or discovered by Schering-Plough or its Affiliates after Schering-Plough’s selection for Development of a Collaboration Product for such Program Target and prior to the earlier of (i) the time that such Program Target has become a Released Target or Reverted Target and (ii) the expiration or earlier termination of this Agreement with respect to such Collaboration Product pursuant to Article 15 hereof; or (d) is otherwise designated a Program Antisense Compound by the Joint Management Committee.

1.58 “Program Intellectual Property” means Program Patent Rights and any other proprietary rights in Program Material and Program Technology.

1.59 “Program Materials” means (a) any Program Antibodies, (b) any Program Antisense Compounds, (c) any Program Proteins, and (d) any other materials other than Program Antibodies, Program Antisense Compounds or Program Proteins first identified or discovered in the conduct of the Collaboration. For clarity, Program Materials specifically excludes Small Molecule Compounds, including, without limitation, Small Molecule Compounds acting through Program Targets.

1.60 “Program Patent Rights” means any Patent Rights that are Controlled by one or both parties and that Cover any Program Technology or Program Materials. For clarification, such Program Patent Rights include the entire scope of all of the claims contained in such Patent Rights.

1.61 “Program Protein” means a Protein that: (a) (i) is selected by the Joint Research Committee for research, optimization or preclinical evaluation in the conduct of the Collaboration, (ii) is Controlled by a party, and (iii) is encoded by a Program Target or derived from (*e.g.*, by means of amino acid substitutions, additions, deletions, and C- and N-terminal fusions) a Protein encoded by a Program Target; (b) is first [\*\*] in the conduct of the Collaboration; (c) is encoded by a Program Target or derived from (*e.g.*, by means of amino acid substitutions, additions, deletions, and C - - and N-terminal fusions) a Protein encoded by a Program Target and is first identified or discovered by Schering-Plough or its Affiliates after Schering-Plough’s selection for Development of a Collaboration Product for such Program Target and prior to the earlier of (i) the time that such Program Target has become a Released Target or Reverted Target and (ii) the expiration or earlier termination of this Agreement with respect to such Collaboration Product pursuant to Article 15 hereof; or (d) is otherwise designated a Program Protein by the Joint Management Committee.

1.62 “Program Target” means one of the three hundred (300) human genes selected in accordance with the Predecessor Agreement (in each case, identified by the full-length cDNA or amino acid sequence of the gene or, in the event the gene has more than one splice variant form, by the full-length cDNA or amino acid sequence of at least one splice variant form of such gene) and the products encoded by such gene, including, without limitation, (a) any [\*\*] from such gene [\*\*], (b) any [\*\*] encoded by any such gene, and (c) any [\*\*] encoded by any such gene.

1.63 “Program Technology” means any inventions, information, methods, know-how, trade secrets or data that (a) are Controlled by a party or jointly by the parties and (b)(i) relate to the use of Program Antibodies, Program Antisense Compounds or Program Proteins, (ii) relate to the use of a Program Target to identify Antibodies or Antisense Compounds acting through such Program Targets, and the use of such Antibodies or Antisense Compounds in the Field, (iii) relate to the use of Protein(s) encoded by such Program Target in the Field, or (iv) are first identified or discovered in the conduct of the Collaboration or in the Development of a Collaboration Product. Notwithstanding the for egoing, Program Technology does not include any inventions, information, methods, know-how, trade secrets or data (A) relating to [\*\*], (B) relating to [\*\*], in each case that do not [\*\*], or (C) relating to Small Molecule Compounds or uses thereof, including, without limitation, Small Molecule Compounds acting through Program Targets.

1.64 “Protein” means a composition comprising a high molecular weight (*i.e.*, weighing more than [\*\*]), polymer compound composed of a variety of amino acids joined by peptide linkages, or any fragment thereof.

1.65 “Receiving Party” has the meaning specified in Section 1.17 hereof.

1.66 “Regulatory Approval” means any and all approvals (including any applicable governmental price and reimbursement approvals), licenses, registrations, or authorizations of any federal, national, multinational, state, provincial or local regulatory agency, department bureau or other governmental entity that are necessary for the Manufacture, use, storage, import, transport, promotion, marketing and sale of a Collaboration Product (or, as applicable, Reverted Product) in the Field in a country or group of countries.

1.67 “Regulatory Authority” means any governmental authority in a country or region that regulates the manufacture or sale of pharmaceutical products, including the FDA and the EMEA, and any successors thereto.

1.68 “Released Product” means any and all of the following: (a) a Program Antibody or Program Antisense Compound that acts through a Released Target, or (b) a Program Protein that is encoded by a Released Target, including, in each such case, any such Program Antibody, Program Antisense Compound or Program Protein that had been selected by Schering-Plough for Development as a Collaboration Product.

1.69 “Released Target” means (a) one of the [\*\*] Program Targets separately designated by the parties in writing as being released from the Collaboration effective as of the Effective Date, (b) a Program Target that is designated by the Joint Management Committee, in accordance with Section 2.3, as being released from the Collaboration effective as of the date of such designation, or (c) a Reverted Target that is subsequently designated as such by Schering-Plough, subject to and in accordance with the provisions of Section 9.4, as its remedy for Lexicon’s failure to satisfy its diligence obligations with respect thereto.

1.70 “Reverted Product” means any and all of the following: (a)(i) a Program Antibody or Program Antisense Compound that acts through a Reverted Target, or (ii) a Program Protein that is encoded by a Reverted Target, including, in each such case, any such Program Antibody, Program Antisense Compound or Program Protein that had been selected by Schering-Plough for Development as a Collaboration Product; and (b) any other Antibody, Antisense Compound or Protein that is claimed in a Program Patent Right and that has been developed or acquired by Lexicon after such target has been designated a Reverted Target.

1.71 “Reverted Target” means (a) a Program Target for which rights are vested in Lexicon in accordance with Section 2.3, effective as of the date of such vesting, or (b) a Program Target designated as such by Lexicon, subject to and in accordance with the provisions of Section 9.2, as its remedy for Schering-Plough’s failure to satisfy its diligence obligations with respect thereto.

1.72 “Schering-Plough Background Materials” means any Antibodies, Antisense Compounds, Proteins, assays, reagents or other materials that are (a) necessary or reasonably useful for the conduct of the Collaboration, (b) Controlled by Schering-Plough, (c) utilized in the Collaboration (but only to the extent so utilized) and (d) either in Schering-Plough’s or any of its Affiliates’ possession as of the Predecessor Agreement Effective Date (in the case of Organon or Intervet) or as of the Acquisition Effective Date (in the case of Schering-Plough and its Affiliates other than Organon or Intervet) or discovered or acquired by Schering-Plough or any of its Affiliates during the Collaboration Term but outside of the conduct of the Collaboration. Schering-Plough Background Materials excludes Program Targets, Program Antibodies, Program Antisense Compounds and Program Proteins.

1.73 “Schering-Plough Background Technology” means any inventions, information, methods, know-how, trade secrets or data that (a) are necessary or reasonably useful for the performance of the Collaboration, (b) are Controlled by Schering-Plough, (c) are utilized in the Collaboration (but only to the extent so utilized) and (d) either are in Schering-Plough’s or any of its Affiliates’ possession as of the Predecessor Agreement Effective Date (in the case of Organon or Intervet) or as of the Acquisition Effective Date (in the case of Schering-Plough and its Affiliates other than Organon or Intervet) or are discovered or acquired by Schering-Plough or any of its Affiliates during the Co llaboration Term but outside of the conduct of the Collaboration. Schering-Plough Background Technology also includes any inventions, information, methods, know-how, trade secrets or data (i) relating to research and development methods and processes first identified or discovered by Schering-Plough or its Affiliates in the course of performing Biotherapeutics Research or Development activities under the Collaboration or (ii) relating to manufacturing and analytical methods and processes first identified or discovered by Schering-Plough or its Affiliates in the course of manufacture of a Collaboration Product, in each case that are not Program Technology.

1.74 “Small Molecule Compound” means a composition comprising a chemical compound, whether synthetic or naturally-derived, that is not an Antibody, an Antisense Compound or a Protein.

1.75 “Target Function Discovery Program” has the meaning specified in Section 2.1.1.1 hereof.

1.76 “Target Function Discovery Program Costs” means the following amounts:

(a) the costs of internal scientific, medical, technical and managerial personnel of Lexicon or its Affiliates engaged in [\*\*] (together with all associated laboratory supplies, facilities and occupancy costs) from and after the Effective Date, which costs shall be determined based on FTE Costs, unless another basis is otherwise agreed upon by the parties in writing; and

(b) out-of-pocket expenditures, if any, expressly approved by the Joint Management Committee and actually incurred after the Effective Date by Lexicon or its Affiliate(s) in conducting the Target Function Discovery Program, subject to Section 2.2.4.

1.77 “Target Function Discovery Program Term” has the meaning specified in Section 4.1.2 hereof.

1.78 “Territory” means all of the countries of the world.

1.79 “Therapeutic Area” means any one of the following areas with respect to which the Joint Research Committee may approve Level 2 Phenotypic Analysis of Mutant Mice relating to a Program Target: (a) metabolism and endocrinology, (b) cardiology, (c) neurology, (d) oncology, (e) immunology, (f) ophthalmology and (g) any other therapeutic area for which Lexicon subsequently develops Level 2 Phenotypic Analysis capabilities and focuses its own internal drug discovery efforts.

1.80 “Third Party” means any person or entity other than Lexicon, Schering-Plough and their respective Affiliates.

1.81 “Valid Claim” means a claim of an issued and unexpired patent which has not been held permanently revoked, unenforceable or invalid by a decision of a court or other governmental agency of competent jurisdiction, unappealable or unappealed within the time allowed for appeal and that is not admitted to be invalid or unenforceable through reissue, disclaimer or otherwise.



## ARTICLE 2. COLLABORATION OVERVIEW

### 2.1 General.

2.1.1 Objectives. The parties intend to carry out their obligations and responsibilities under the Collaboration in accordance with the provisions of Articles 2, 5, 6 and 7 of this Agreement. It is intended that Biotherapeutics Research will be conducted as a unified collaborative effort with activities by the parties carried out primarily at each party's respective facilities, and this intent shall be reflected in the applicable Biotherapeutics Research Plan(s). In support of the Collaboration, Lexicon will conduct efforts, using its technology for the generation and analysis of the phenotypes of Mutant Mice, to identify and validate Program Targets with potential utility in the Field (the "Target Function Discovery Program").

2.1.2 Collaboration Term. The Collaboration shall be deemed to have commenced on the Predecessor Agreement Effective Date with respect to Lexicon, Organon and Intervet, and on the Acquisition Effective Date with respect to Schering-Plough, and shall continue on a Program Target-by-Program Target basis, until the earliest of (a) the time that such Program Target has become a Released Target or Reverted Target, (b) the time that a Collaboration Product for such Program Target has been selected for Development by Schering-Plough, and (c) the expiration or earlier termination of this Agreement pursuant to Article 15 hereof (the "Collaboration Term").

### 2.2 Conduct of Collaboration.

2.2.1 Efforts. The parties shall conduct the Collaboration in good scientific manner in accordance and in compliance with applicable Laws. Each party shall use Diligent Efforts to conduct the activities of the Collaboration that are assigned to it under this Agreement or a Biotherapeutics Research Plan, and each shall devote sufficient resources to carry out such respective activities. While the parties acknowledge and agree that neither party guarantees the success of the Collaboration or any individual task undertaken thereunder, each party agrees that it will perform the activities assigned to it under the Collaboration in a professional manner.

2.2.2 Resources. Over the course of the Collaboration, tasks will be allocated between the parties in accordance with the following principles and objectives: (a) Lexicon will be solely responsible for conducting the Target Function Discovery Program; (b) except to the extent otherwise provided in an applicable Biotherapeutics Research Plan, Schering-Plough will be principally responsible for conducting Biotherapeutics Research activities; and (c) Schering-Plough will be exclusively responsible for Development and Commercialization activities.

2.2.3 Subcontractors. In accordance with Section 2.2.2, the parties will endeavor to optimize the allocation of their resources for the conduct of the Collaboration. As necessary and in furtherance of the Collaboration, however, (a) Lexicon may enter into agreements or subcontracts for Target Function Discovery Program activities in accordance with this Section 2.2.3, (b) either party may enter into agreements or subcontracts for Biotherapeutics Research activities in accordance with this Section 2.2.3, and (c) Schering-Plough may enter into agreements or subcontracts for Development or Commercialization activities in accordance with this Section 2.2.3; *pro vided* that (i) none of the rights of the other party hereunder are diminished or otherwise adversely affected as a result of such subcontracting and (ii) the subcontractor undertakes in writing obligations of confidentiality and non-use regarding the other party's Confidential Information that are substantially the same as those undertaken by Schering-Plough and Lexicon pursuant to Article 12 hereof. In the event a party performs one or more of its obligations under the Collaboration through a subcontractor, then such party shall at all times be responsible for the performance of such subcontractor.

2.2.4 Reports. Lexicon shall submit reports, not less than [\*\*], to the Joint Management Committee detailing its activities under the Target Function Discovery Program. Each party shall submit reports, not less than [\*\*], to the Joint Management Committee, as may be required by the then-current Biotherapeutics Research Plan(s), detailing its activities under the Biotherapeutics Research Program.

2.3 Release and Reversion of Program Targets. The parties have designated [\*\*] Program Targets as Released Targets effective as of the Effective Date. Upon the request of Schering-Plough at any time with respect to any other Program Target that has not become a Reverted Target, the Joint Management Committee will consider in good faith whether such Program Target should be designated as a Released Target, and may, by unanimous agreement of its members, designate such Program Target as a Released Target, effective as of the date of such designation. In the absence of such a designation, Schering-Plough may, at its option, designate any such Program Target as a Released Target by delivering written notice of such designation to Lexicon, and such Program Target shall become a Released Target [\*\*] following such notice unless Lexicon shall have delivered notice to Schering-Plough within such [\*\*] period of its election to designate such Program Target as a Reverted Target, with rights to such Reverted Target vesting in Lexicon effective as of the date of such notice. In addition, Lexicon may, at its option, designate as a Reverted Target any Program Target with respect to which Schering-Plough has failed to satisfy its diligence obligations under Section 9.1, subject to and in accordance with the provisions of Section 9.2. Lexicon shall have the rights set forth in Sections 8.2.2 and 9.2, subject to the obligations set forth in Sections 9.4, 10.5 and 10.6, with respect to Reverted Products.

2.4 Exclusivity. During the Collaboration Term, each party shall work exclusively with the other party under the terms of this Agreement with respect to Biotherapeutics Research, Development and Commercialization of (a) Program Antibodies, Program Antisense Compounds and other Antibodies and Antisense Compounds acting through Program Targets that have not become Released Targets or Reverted Targets and (b) Program Proteins and other Protein(s) encoded by Program Targets that have not become Released Targets or Reverted Targets. Without limiting the foregoing, during the Collaboration Term, neither party nor any of its Affiliates shall research, develop or Commercialize (a) any Antibody or Antisense Compound acting through a Program Target that has not become a Released Target or Reverted Target or (b) any Protein encoded by a Program Target that has not become a Released Target or Reverted Target, except for the Biotherapeutics Research of Program Antibodies, Program Antisense Compounds and Program Proteins and the Development and Commercialization of Collaboration Products, in each case in the Collaboration and in accordance with the terms of this Agreement. In addition, after Schering-Plough's selection for Development of a Collaboration Product for a Program Target, neither party nor any of its Affiliates shall research, Develop or Commercialize (a) any Antibody or Antisense Compound acting through such Program Target or (b) any Protein encoded by such Program Target, except for the Biotherapeutics Research of Program Antibodies, Program Antisense Compounds and Program Proteins and the Development and Commercialization of Collaboration Products, in each case in accordance with the terms of this Agreement, until the earlier of (i) the time that such Program Target has become a Released Target or Reverted Target, and (ii) the expiration or earlier termination of this Agreement with respect to such Collaboration Product pursuant to Article 15 hereof. For the avoidance of doubt, the exclusivity provisions of this section shall not apply to any Program Target that becomes a Released Target or a Reverted Target.

## 2.5 Collaboration Records.

2.5.1 All work conducted by each party in the course of the Collaboration shall be completely and accurately recorded, in reasonable detail and in good scientific manner, in separate laboratory notebooks. On reasonable notice, and at reasonable intervals, each party shall have the right to inspect and copy all such records of the other party reflecting Program Technology or work done under the Collaboration, to the extent reasonably required to carry out its respective obligations and to exercise its respective rights hereunder. Notwithstanding the definition of "Confidential Information," all such records shall constitute Confidential Information of the party owning such records.

2.5.2 In order to protect the parties' Patent Rights under U.S. law in any inventions conceived or reduced to practice during or as a result of the Collaboration, each party agrees to maintain a policy or set of procedures that requires its employees to record and maintain all data and information developed during the Collaboration in such a manner as to enable the parties to use such records to establish the earliest date of invention or diligence to reduction to practice. At a minimum, the policy or procedures shall require such individuals to record all inventions generated by them in standard laboratory notebooks or other suitable means that are dated and corroborated by non-inventors on a regular, contemporaneous basis.

2.6 Disclosure of Collaboration Results. Subject to restrictions imposed by a party's confidentiality obligations to any Third Party with respect to Background Materials or Background Technology, each party will disclose to the Joint Research Committee all Program Technology that is discovered, invented or made by such party during the course of the Collaboration and that is useful in or relates to the Collaboration, including, without limitation, information regarding Program Targets, Program Antibodies, Program Antisense Compounds and Program Proteins and uses thereof and the results of all Biotherapeutics Research studies. Such Program Technology will be promptly disclosed to the Joint Research Committee, with meaningful discoveries or advances being communicated as promptly as practicable after such information is obtained or its significance is appreciated. Upon written request by any member of the Joint Research Committee, each party will provide the other with copies of the raw data generated in the course of the Collaboration, if reasonably necessary to the other party's work under the Collaboration. Any information disclosed pursuant to this Section 2.6 may be used by the other party solely for the purposes of the Collaboration or as otherwise expressly permitted in this Agreement.

2.7 Material Transfer. In order to facilitate the Collaboration, either party may provide to the other party certain Program Materials and Background Materials Controlled by the supplying party (other than under this Agreement) for use by the other party in furtherance of the Collaboration. All such Program Materials shall be considered the Confidential Information of both parties and shall be subject to the restrictions in Article 12. All Background Materials shall be considered the Confidential Information of the supplying party and shall be subject to the restrictions in Article 12. Except as otherwise provided under this Agreement, all such Program Materials and Background Materials delivered to the other party shall remain the sole property of the supplying party, shall be used only in furtherance of the Collaboration and solely under the control of the other party and its Affiliates, shall not be used or delivered to or for the benefit of any Third Party without the prior written consent of the supplying party and shall not be used in research or testing involving human subjects. The Program Materials and Background Materials supplied under this Section 2.7 must be used with prudence and appropriate caution in any experimental work, since not all of their characteristics may be known. THE PROGRAM MATERIALS AND BACKGROUND MATERIALS ARE PROVIDED "AS IS" AND WITHOUT ANY REPRESENTATION OR WARRANTY, EXPRESS OR IMPLIED, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTY OF MERCHANTABILITY OR OF FITNESS FOR ANY PARTICULAR PURPOSE OR ANY WARRANTY THAT THE USE OF THE MATERIALS WILL NOT INFRINGE OR VIOLATE ANY PATENT OR OTHER PROPRIETARY RIGHTS OF ANY THIRD PARTY.</div>

2.8 **Third Party Licenses.** During the Collaboration Term, either party may propose that the Joint Management Committee determine whether a Third Party license is required or beneficial for Biotherapeutics Research of a Program Target or of a Collaboration Product in the Field. In the event the Joint Management Committee determines that such Third Party license is required or beneficial, Schering-Plough shall be responsible for obtaining such license. In making any such determination provided for in this Section 2.8 as to the need for or benefit of any such Third Party license, due consideration shall be given to the advisability of seeking an opinion of counsel and the efforts required to design around the patents at issue.

2.9 **Regulatory Matters.** The preparation, filing, prosecution and maintenance of INDs, BLAs and other regulatory filings required to be filed with any Regulatory Authority with regard to each Collaboration Product will be in the name of and the responsibility of Schering-Plough. Schering-Plough shall oversee, monitor and coordinate all regulatory actions, communications and filings with and submissions, including filings and submissions of supplements and amendments thereto, to Regulatory Authorities with respect to each Collaboration Product.

### ARTICLE 3. COLLABORATION MANAGEMENT

#### 3.1 Collaboration Committees.

3.1.1 **Joint Management Committee.** As soon as practicable after the Effective Date, Schering-Plough and Lexicon shall establish a Joint Management Committee (the "Joint Management Committee") comprised of [\*\*] representatives designated by Schering-Plough and [\*\*] representatives designated by Lexicon, each of whom shall have experience and seniority sufficient to enable him or her to make decisions on behalf of the party he or she represents; *provided* that Schering-Plough and Lexicon may, by mutual agreement, designate an appropriate number of additional representatives from time to time.

3.1.2 **Joint Research Committee.** As soon as practicable after the Effective Date, Schering-Plough and Lexicon shall establish a Joint Research Committee (the "Joint Research Committee") comprised of [\*\*] representatives designated by Schering-Plough and [\*\*] representatives designated by Lexicon, each of whom shall have experience and seniority sufficient to enable him or her to make decisions on behalf of the party he or she represents; *provided* that Schering-Plough and Lexicon may, by mutual agreement, designate an appropriate number of additional representatives from time to time. From time to time during the Collaboration Term, the Joint Research Committee may establish one or more Joint Research Project Teams (each, a "Joint Research Project Team") to implement various aspects of the applicable Biotherapeutics Research Plan. Such teams shall be governed in the same manner and subject to the relevant requirements as set forth herein for the Joint Research Committee.

3.2 **Program Directors.** Each party shall appoint one of its designees on the Joint Management Committee (and who may, but need not also be, a member of the Joint Research Committee) to serve as a program director (each, a "Program Director") with responsibility for overseeing the day-to-day activities of the parties with respect to the Collaboration and for being the primary point of contact between the parties with respect to the Collaboration.

3.3 **Replacement of Collaboration Committee Representatives and Program Directors.** Each party shall be free to replace its representative members of any Collaboration Committee and its Program Director with new appointees who have authority to act on behalf of such party, on notice to the other party.

3.4 Responsibilities of Joint Management Committee. The Joint Management Committee shall be responsible for overseeing and directing the parties' interaction and performance of their respective obligations under this Agreement. Without limiting the generality of the foregoing, its duties during its term shall include:

- (a) preparing such procedures as may be necessary for the operation of the Joint Management Committee, Joint Research Committee, and other committees the Joint Management Committee decides to establish to assure the efficient operation of the Collaboration;
- (b) reviewing and approving the annual Biotherapeutics Research Plans proposed by the Joint Research Committee, including the budget for any Lexicon work to be funded by Schering-Plough, and any modifications thereto as recommended by the Joint Research Committee;
- (c) overseeing the implementation of such Biotherapeutics Research Plans;
- (d) upon request by Schering-Plough, promptly determining whether to designate a Program Target as a Released Target;
- (e) facilitating the transfer of technology between the parties through the Joint Research Committee;
- (f) overseeing Patent Prosecution and other matters contemplated by Article 12 and, if appropriate, delegating responsibility for such matters, subject to oversight by the Joint Management Committee, to a committee appointed by the Joint Management Committee for such purpose;
- (g) evaluating potential licenses from Third Parties, and determining their utility in the Collaboration (if any);
- (h) evaluating the progress of the Joint Research Committee, and on a quarterly basis at a minimum, evaluating the progress of the Biotherapeutics Research Plan against its respective timeline;
- (i) overseeing the maintenance of an inventory of the assets generated pursuant to the Collaboration;
- (j) resolving matters within the responsibilities of the Joint Research Committee as to which the members of the Joint Research Committee are unable to reach a consensus, and dissolving the Joint Research Committee when its duties under the Collaboration are complete;
- (k) resolving disagreements between the parties with respect to the matters contemplated by Article 8 hereof; and
- (l) addressing issues and resolving differences that may arise between the parties.

The Joint Management Committee shall not have the power to amend the terms of or waive compliance with this Agreement.

3.5 Responsibilities of Joint Research Committee. The Joint Research Committee shall be responsible for preparing for approval by the Joint Management Committee and implementing the applicable annual Biotherapeutics Research Plan, with the objective of expeditiously identifying Program Antibodies, Program Antisense Compounds and Program Proteins meeting the criteria for Development as Collaboration Products. Without limiting the generality of the foregoing, its duties during its term shall include:

- (a) overseeing the implementation of the Target Function Discovery Program;
- (b) establishing criteria for the selection of Program Antibodies, Program Antisense Compounds and Program Proteins;
- (c) selecting Program Antibodies, Program Antisense Compounds and Program Proteins for characterization and optimization in the conduct of the Collaboration;
- (d) monitoring, reviewing and reporting on the progress of the Biotherapeutics Research Program;
- (e) recommending Program Antibodies, Program Antisense Compounds and Program Proteins for Development by Schering-Plough as Collaboration Products; and
- (f) performing such other activities as are contemplated by the terms of this Agreement.

The Joint Research Committee shall report its activities and make proposals to the Joint Management Committee at least [\*\*], but more frequently as appropriate. The Joint Research Committee shall not have the power to amend or waive compliance with this Agreement.

3.6 Meetings of Collaboration Committees. As applicable, each Collaboration Committee shall meet at least [\*\*], or as frequently as the parties deem appropriate, on such dates and at such times as the parties shall agree, on [\*\*] written notice to the other party unless such notice is waived by the parties. Each Collaboration Committee may convene or be polled or consulted from time to time by means of telecommunications, videoconferences or correspondence, as deemed necessary or appropriate by the parties. To the extent that meetings are held in person, they shall alternate between the offices of the parties unless the parties otherwise agree.

3.7 Decisions.

3.7.1 Quorum; Voting. A quorum for a meeting of a Collaboration Committee shall require the presence of at least one Lexicon member (or designee) and at least one Schering-Plough member (or designee) in person or by telephone. All decisions made or actions taken by a Collaboration Committee shall be made unanimously by its members, with the Lexicon members cumulatively having one vote and the Schering-Plough members cumulatively having one vote; *provided* that, in the event the members of the Joint Management Committee are unable to reach unanimity as to the approval of a Biotherapeutics Research Plan or budget under Section 3.4( b), then, subject to the obligations of Schering-Plough under Section 9.1, the members of the Joint Management Committee designated by Schering-Plough shall have the right to approve such Biotherapeutics Research Plan and budget; *provided, further*, that in no event shall Lexicon or its Affiliates be assigned any responsibilities or obligations under any Biotherapeutics Research Plan without the agreement of the Lexicon members of the Joint Management Committee.

### 3.7.2 Dispute Resolution.

3.7.2.1 In the event that unanimity cannot be reached by the Joint Research Committee with respect to a matter that is a subject of its decision-making authority, then the matter shall be referred for further review and resolution to the Joint Management Committee. In the event that unanimity cannot be reached by the Joint Management Committee with respect to a matter that is a subject of its decision-making authority, then the matter shall be referred for further review and resolution to the President of Schering-Plough's research division, or such other similar position designated by Schering-Plough from time to time, and the Chief Executive Officer of Lexicon, or such other similar position designated by Lexicon from time to time. The designated officers of each party shall use reasonable efforts to resolve the matter within [\*\*] after the matter is referred to them.

3.7.2.2 If the designated officers cannot resolve any matter pursuant to Section 3.7.2.1 within such [\*\*] period, the matter shall be referred to a Third Party arbitrator or arbitrators, in accordance with the following procedures, whose decision shall be [\*\*]; *provided* that failure of the Joint Management Committee to agree to designate a Program Target as a Released Target shall not be subject to arbitration under this Section 3.7.2.2. The arbitration proceeding shall be conducted under the Commercial Arbitration Rules of the American Arbitration Association, with the proceedings to be held in Houston, Texas if the arbitration is requested by Schering-Plough or in Newark, New Jersey if the proceedings are requested by Lexicon. The parties shall attempt to mutually agree upon a single independent Third Party arbitrator (who shall be a professional with appropriate experience in the subject matter at issue in such disagreement) within [\*\*] after the initial referral of such matter to the designated officers. If the parties are unable to mutually agree upon one such person, then each party shall appoint one independent Third Party professional with appropriate experience in the subject matter at issue in such disagreement prior to the expiration of such [\*\*] period, and within [\*\*] after the initial referral of such matter to the designated officers, such person(s) shall select a single independent Third Party arbitrator, who shall be a professional with appropriate experience in the subject matter at issue in such disagreement. Within [\*\*] after the initial referral of such matter to the designated officers, the arbitrator shall provide written notice to the parties regarding his or her determination regarding such disagreement.

3.8 Administration. The chairperson of each Collaboration Committee shall be designated annually on an alternating basis between the parties. The initial chairperson shall be selected by Schering-Plough. The party not designating the chairperson shall designate one of its representative members as secretary to such Collaboration Committee for such year. The chairperson shall be responsible for calling meetings of such Collaboration Committee, sending notices of meetings to all members and for leading such meetings.

3.9 Minutes. Within [\*\*] after each Collaboration Committee meeting, the secretary of such Collaboration Committee shall prepare and distribute minutes of the meeting, that shall provide a description in reasonable detail of the discussions had at the meeting and a list of any actions, decisions or determinations approved by such Collaboration Committee. The secretary shall be responsible for circulation of all draft and final minutes. Draft minutes shall be first circulated to the chairperson, edited by the chairperson and then circulated in final draft form to all members of such Collaboration Committee sufficiently in advance of the next meeting to allow adequate review and comment prior to the meeting. Minutes shall be approved or disapproved, and revised as necessary, at the next meeting. Final minutes shall be distributed to the members of such Collaboration Committee.

3.10 Term. The Joint Management Committee shall exist until the termination or expiration of the Collaboration Term. Each other Collaboration Committee shall exist until the termination or expiration of the Collaboration Term unless earlier dissolved by the Joint Management Committee following the completion of its duties under the Collaboration.

3.11 Expenses. Each party shall be responsible for all travel and related costs for its representatives to attend meetings of, and otherwise participate on, a Collaboration Committee.

#### **ARTICLE 4. TARGET FUNCTION DISCOVERY PROGRAM**

##### **4.1 General**

4.1.1 Generation and Analysis of Mutant Mice. The parties acknowledge and agree that, as of the Effective Date, Lexicon has completed the development and Level 1 Phenotypic Analysis of Mutant Mice for each Program Target that has not become a Released Target or Reverted Target. During the balance of the Target Function Discovery Program, Lexicon shall use Diligent Efforts to complete Level 2 Phenotypic Analysis of lines of Mutant Mice under the supervision of the Joint Research Committee and to the extent and degree specified in the Predecessor Agreement.

4.1.2 Target Function Discovery Program Term. The Target Function Discovery Program shall continue until December 31, 2009 and all work under the Target Function Discovery Program shall be completed by that date (the "Target Function Discovery Program Term").

4.2 Reporting and Oversight of Target Function Discovery Program Progress. Lexicon shall keep the Joint Research Committee fully informed of the progress of its activities under the Target Function Discovery Program. Within [\*\*] following the Effective Date, Lexicon shall prepare, and provide to the Joint Research Committee, a reasonably detailed written summary report which shall (a) describe the work performed by Lexicon in the Target Function Discovery Program since its last report to the Joint Research Committee regarding the Target Function Discovery Program, and (b) describe the phenotypes identified through such work that are suggestive, in Lexicon's good faith scientific judgment, of the potential utility of the corresponding Program Targets in the Field. In addition, Lexicon shall provide the Joint Research Committee with access to all data, information and conclusions from such work so as to enable the Joint Research Committee to make its own determinations as to which Mutant Mice exhibit a phenotype suggestive of the potential utility of the corresponding Program Target in the Field. For each such phenotype described, that in the opinion of the Joint Research Committee warrants further consideration of a Biotherapeutics Research Plan, the Joint Research Committee will provide the basis for such opinion to the Joint Management Committee. Similarly, the Joint Research Committee will present the information for those Program Targets that in its opinion, based on the phenotypic information described, do not warrant further consideration for a Biotherapeutics Research Plan. Based on the presentation of such information, the Joint Management Committee will decide which Program Targets should progress to a Biotherapeutics Research Plan and which shall be designated as Released Targets.

4.3 Requests for Mice for Released Targets. For [\*\*] (but no longer than [\*\*]), upon the request of Schering-Plough for a line of Mutant Mice made in the Target Function Discovery Program for such Released Target, Lexicon shall use Diligent Efforts to transfer to Schering-Plough a viable, healthy breeding pair of mice from such line of such Mutant Mice, with the obligation to supply a replacement pair if necessary, for Schering-Plough's internal research use.



## ARTICLE 5. BIOTHERAPEUTICS RESEARCH PROGRAM

5.1 General. The parties shall continue to pursue Biotherapeutics Research relating to Program Targets that have not become Released Targets or Reverted Targets under the direction of the Joint Research Committee in accordance with annual Biotherapeutics Research Plans. Unless otherwise agreed by the Joint Management Committee, Schering-Plough will be principally responsible for conducting Biotherapeutics Research activities from and after the Effective Date, with Lexicon participating in such activities to the extent provided in an applicable Biotherapeutics Research Plan.

### 5.2 Biotherapeutics Research Plans.

5.2.1 The Joint Research Committee shall prepare and the Joint Management Committee shall approve the Biotherapeutics Research Plan for every Contract Year (other than the First Contract Year) following the Effective Date during the Collaboration Term at least [\*\*] prior to the commencement of such Contract Year. The Biotherapeutics Research Plan for the First Contract Year shall be prepared by the Joint Research Committee and approved by the Joint Management Committee within [\*\*] after the Effective Date. The responsibility of the Joint Research Committee to prepare annual Biotherapeutics Research Plans shall terminate upon the agreement of the parties to cease further Biotherapeutics Research regarding Program Targets.

5.2.2 Each annual Biotherapeutics Research Plan shall be in writing and shall set forth with reasonable specificity the Biotherapeutics Research objectives, priorities, activities, milestones, budgets, personnel requirements, other resources and allocations of responsibilities between the parties for the period covered by such annual Biotherapeutics Research Plan in a manner consistent with the terms of this Agreement, including, without limitation, the objectives set forth in Section 2.1.1, the terms and conditions set forth in Section 2.2, and Schering-Plough's obligations under Section 9.1. The Biotherapeutics Research Plans shall cover all aspects of Biotherapeutics Research relating to the generation of Antibodies, Antisense Compounds and Proteins relating to Program Targets that have not become Released Targets or Reverted Targets and the identification, characterization, selection, optimization and research of Program Antibodies, Program Antisense Compounds and Program Proteins prior to their designation as Collaboration Products, and shall include, with reasonable specificity, the Biotherapeutics Research activities to be performed by each party and the Biotherapeutics Research activities, if any, to be performed by subcontractors.

5.2.3 The Joint Research Committee may agree on modifications, and recommend that the Joint Management Committee approve such modifications, to the provisions of any Biotherapeutics Research Plan at any time. Without limiting the foregoing, the Joint Research Committee shall conduct a [\*\*] review of each Biotherapeutics Research Plan and shall recommend that the Joint Management Committee approve such modifications to the applicable Biotherapeutics Research Plan as the Joint Research Committee may deem to be appropriate as a result of such review.

## ARTICLE 6. DEVELOPMENT PROGRAMS

6.1 General. Schering-Plough shall be solely responsible for the Development of Collaboration Products in the Field subject to its obligations under Section 9.1. Lexicon shall be solely responsible for the Development of Reverted Products in the Field subject to its obligations under Section 9.4.

6.2 Selection of Collaboration Products for Development. Schering-Plough shall be responsible, subject to its obligations under Section 9.1, for selecting Program Antibodies, Program Antisense Compounds and Program Proteins (with respect to Program Targets other than Released Targets or Reverted Targets) for Development as Collaboration Products, and shall promptly notify the Joint Management Committee of each such Program Antibody, Program Protein or Program Antisense Compound that has been selected by Schering-Plough as a development candidate; *provided* that the initiation of GLP toxicology studies with respect to a Program Antibody, Program Antisense Compound or Program Protein produced under GMP conditions shall be conclusively deemed to constitute its selection for Development as a Collaboration Product. Lexicon shall have the reciprocal obligations for any Reverted Product.

6.3 Annual Development Reports. Within [\*\*] of finalizing and approving an early Development plan for a Collaboration Product, Schering-Plough will provide a summary of the plan to Lexicon. Thereafter, Schering-Plough will provide Lexicon with an annual report on the progress under such plan and projections for the Development plan for the upcoming year, such reports to be the Confidential Information of Schering-Plough. Lexicon shall have the reciprocal obligations for any Reverted Product.

## ARTICLE 7. COMMERCIALIZATION OF COLLABORATION PRODUCTS

7.1 General. Schering-Plough shall be solely responsible for the Commercialization of Collaboration Products in the Field subject to its obligations under Section 9.1. Lexicon shall be solely responsible for the Commercialization of Reverted Products in the Field subject to its obligations under Section 9.4.

7.2 Annual Commercialization Reports. Schering-Plough will promptly notify Lexicon of all Regulatory Approvals for Collaboration Products and will provide royalty reports on any Net Sales of such Collaboration Product pursuant to Section 10.4.3 herein. Lexicon shall have the reciprocal obligations for any Reverted Product.

## ARTICLE 8. GRANTS OF RIGHTS

8.1 Grants of Research Licenses for Purposes of Collaboration.

8.1.1 By Lexicon. Subject to the terms of this Agreement, during the Collaboration Term, Lexicon hereby grants to Schering-Plough and its Affiliates, within the Territory, (a) a non-exclusive right and license (without any right to sublicense, except as set forth below) under Lexicon's rights in the Lexicon Background Materials and the Lexicon Background Technology, including, without limitation, any Patent Rights Controlled by Lexicon Covering the foregoing, and (b) a co-exclusive right and license (without any right to sublicense, except as set forth below) under Lexicon's rights in the Program Intellectual Property, in each case to (i) generate Antibodies, Antisense Compounds and Proteins relating to Program Targets that have not become Released Targets or Reverted Targets and (ii) identify, characterize, select, optimize and research Program Antibodies, Program Antisense Compounds and Program Proteins relating to such Program Targets prior to their designation as Collaboration Products, in each case in the conduct of the Collaboration. Such right and license shall include the right to grant sublicenses to Affiliates of Schering-Plough and to Third Parties that are approved by the Joint Management Committee.

8.1.2 By Schering-Plough. Subject to the terms of this Agreement, during the Collaboration Term, Schering-Plough hereby grants to Lexicon and its Affiliates, within the Territory, (a) a non-exclusive right and license (without any right to sublicense, except as set forth below) under Schering-Plough's rights in the Schering-Plough Background Materials and the Schering-Plough Background Technology, including, without limitation, any Patent Rights Controlled by Schering-Plough Covering the foregoing, and (b) a co-exclusive right and license (without any right to sublicense, except as set forth below) under Schering-Plough's rights in the Program Intellectual Property, in each case to (i) generate Antibodies, Antisense Compounds and Proteins relating to Program Targets that have not become Released Targets and (ii) identify, characterize, select, optimize and research Program Antibodies, Program Antisense Compounds and Program Proteins relating to such Program Targets prior to their designation as Collaboration Products, in each case in the conduct of the Collaboration. Such right and license shall include the right to grant sublicenses to Affiliates of Lexicon and to Third Parties that are approved by the Joint Management Committee.

## 8.2 Grants of Development and Commercialization Licenses.

8.2.1 By Lexicon. Subject to the terms of this Agreement, Lexicon hereby grants to Schering-Plough and its Affiliates, within the Territory, (a) a non-exclusive right and license, with the right to sublicense, under Lexicon's rights in the Lexicon Background Materials and the Lexicon Background Technology, including, without limitation, any Patent Rights Controlled by Lexicon Covering the foregoing, and (b) an exclusive right and license, with the right to sublicense, under Lexicon's rights in the Program Intellectual Property to research, Develop, make, have made, import, use, have used, offer for sale, sell and have sold Collaboration Products in the Field. Any such sublicense shall be set forth in a written agreement containing confidentiality, non-use, ownership of intellectual property and audit provisions consistent with and no less restrictive than those contained herein, shall be subject and subordinate to the terms and conditions of this Agreement, and shall obligate the (sub)licensee to make the royalty payments required hereunder; *provided* that Schering-Plough shall remain responsible for all payments due to Lexicon hereunder. Schering-Plough shall provide Lexicon with a copy of each sublicense agreement promptly after executing the same; *provided, however*, that subject to the exceptions set forth in Section 1.19, each such sublicense agreement shall be Confidential Information of Schering-Plough.

8.2.2 By Schering-Plough. Subject to the terms of this Agreement, Schering-Plough hereby grants to Lexicon and its Affiliates, within the Territory, (a) a non-exclusive right and license, with the right to sublicense, under Schering-Plough's rights in the Schering-Plough Background Materials and the Schering-Plough Background Technology, including, without limitation, any Patent Rights Controlled by Schering-Plough Covering the foregoing, and (b) an exclusive right and license, with the right to sublicense, under Schering-Plough's rights in the Program Intellectual Property to research, Develop, make, have made, import, use, have used, offer for sale, sell and have sold Reverted Products in the Field. Any such sublicense shall be set forth in a written agreement containing confidentiality, non-use, ownership of intellectual property and audit provisions consistent with and no less restrictive than those contained herein, shall be subject and subordinate to the terms and conditions of this Agreement, and shall obligate the (sub)licensee to make the royalty payments required hereunder; *provided* that Lexicon shall remain responsible for all payments due to Schering-Plough hereunder. Lexicon shall provide Schering-Plough with a copy of each sublicense agreement promptly after executing the same; *provided, however*, that subject to the exceptions set forth in Section 1.19, each such sublicense agreement shall be Confidential Information of Lexicon.

8.3 **Additional Rights to Use of Mutant Mice.** Subject to the terms of this Agreement, in addition to the rights granted under Section 8.1.1, Lexicon hereby grants Schering-Plough and its Affiliates, within the Territory, the right, with respect to lines of Mutant Mice made in the Target Function Discovery Program, to use mice delivered by Lexicon to Schering-Plough pursuant to Section 4.3, and progeny thereof, solely for the internal research use of Schering-Plough and its Affiliates; *provided* that the foregoing rights shall specifically exclude rights to use such mice in the research, development or Commercialization of (a) any Antibody or Antisense Compound acting through a Reverted Target or (b) any Protein encoded by a Reverted Target.

8.4 **Use of Target Function Discovery Program Data.** Subject to the terms of this Agreement, and without either party granting any right or license under the Patent Rights Controlled by such party, Schering-Plough and Lexicon shall each have the right to use the data generated in the Target Function Discovery Program for any purpose other than the Development or Commercialization of Program Antibodies, Program Antisense Compounds, Program Proteins or Collaboration Products or Reverted Products.

8.5 **Released Targets Freedom to Operate and Research License.** Nothing in this Agreement shall restrict either party or any of its Affiliates from conducting research on any of the Released Targets, or from developing and commercializing products (other than previously designated Collaboration Products) that act through or are encoded by Released Targets, on their own or with a Third Party. Additionally, subject to the terms of this Agreement, each party hereby grants to the other party and its Affiliates, within the Territory, a non-exclusive right and license (without any right to sublicense) under such party's rights in the Program Intellectual Property relating to Released Targets, in each case solely for the internal research use of the other party and its Affiliates.

8.6 **No Grant of Other Technology or Patent Rights.** Except as otherwise expressly provided in this Agreement, under no circumstances shall a party hereto, as a result of this Agreement, obtain any ownership interest in or other right to any technology, know-how, patents, patent applications, gene or genomic sequence data or information, products, or biological materials of the other party, including items owned, controlled or developed by, or licensed to, the other party, or transferred by the other party to said party, at any time pursuant to this Agreement.

## ARTICLE 9. DILIGENCE OBLIGATIONS

9.1 **Diligent Efforts.** Subject to the expiration of the ninety-day period set forth in Section 16.3.1, Schering-Plough shall use Diligent Efforts (a) to actively Develop and pursue Regulatory Approval in all Major Markets for at least one Collaboration Product acting through each Program Target that has not become a Released Target or Reverted Target, and (b) following such Regulatory Approval to Commercialize such Collaboration Product.

9.2 **Effect of Failure to Satisfy Diligence Obligations.** With respect to each Program Target that has not become a Released Target for which Schering-Plough fails to timely satisfy its diligence obligations under Section 9.1 above, at the option of Lexicon, as its sole and exclusive remedy therefor, subject to Sections 3.7.2, 15.2 and 16.7 hereof, such Program Target shall become a Reverted Target and (a) the licenses granted under Section 8.2.1 with respect to any Collaboration Product(s) acting through such Program Target shall terminate and such Collaboration Product(s) shall become Reverted Product(s) subject to the licenses granted under Section 8.2.2, (b) Schering-Plough shall deliver to Lexicon copies of all data, information, registrations and applications therefor relating to Collaboration Product(s) acting through such Program Target, to the extent not previously provided, and (c) Lexicon shall have the right, within the period of [\*\*] following Schering-Plough's delivery of such copies, to obtain an assignment and transfer to Lexicon of all regulatory filings and submissions and Regulatory Approvals relating to such Collaboration Product(s) by delivering written notice thereof to Schering-Plough.

9.3 Assignment and Transfer of Materials, Information and Regulatory Filings. With respect to each Collaboration Product for which Lexicon exercises its right, under Section 9.2(c) above, Schering-Plough (a) shall promptly deliver to Lexicon all materials relating to such Collaboration Product (including, without limitation, Program Materials and supplies of such Collaboration Product) in the possession of Schering-Plough and its Affiliates as may be reasonably requested by Lexicon, (b) shall promptly deliver to Lexicon copies of all data and information relating to such Collaboration Product, and (c) shall assign and transfer to Lexicon all regulatory filings and submissions and Regulatory Approvals relating to such Collaboration Product, subject to Lexicon's reimbursement of the out-of-pocket expenses reasonably incurred by Schering-Plough to effect such deliveries, transfer and assignment.

9.4 Lexicon Diligence. Lexicon shall use Diligent Efforts (a) to actively Develop and pursue Regulatory Approval in all Major Markets for at least one Reverted Product acting through each Reverted Target, and (b) following such Regulatory Approval to Commercialize such Reverted Product. With respect to each Reverted Target for which Lexicon fails to timely satisfy its diligence obligations under this Section 9.4 above, at the option of Schering-Plough, as its sole and exclusive remedy therefor, subject to Sections 3.7.2, 15.2 and 16.7 hereof, such Reverted Target shall become a Released Target.

## ARTICLE 10. FINANCIAL TERMS

10.1 Termination and Deemed Satisfaction of Cost Sharing Arrangements under Predecessor Agreement. The parties agree that neither party shall have any financial obligation under the Predecessor Agreement, including, without limitation, with respect to Allowable Costs (as defined in the Predecessor Agreement), all of which are hereby deemed to have been fully satisfied as of the Effective Date or replaced by the financial obligations set forth in this Article 10. For clarity, the parties acknowledge the payments made by Organon under the Predecessor Agreement and agree that all such payments shall be deemed to have been fully earned by Lexicon as of the Effective Date.

10.2 Payment for Mice Requested by Schering-Plough; Funding of Biotherapeutics Research Program Costs and Target Function Discovery Program Costs.

(a) Schering-Plough shall pay Lexicon [\*\*] for each line of Mutant Mice requested by Schering-Plough in accordance with Section 4.3 to cover Lexicon's costs for the rederivation, breeding and shipment of such mice. Lexicon shall deliver to Schering-Plough an invoice for such amount upon shipment. Schering-Plough shall pay Lexicon the invoiced amount within [\*\*] of the receipt of the invoice therefor.

(b) Within [\*\*] of the end of each [\*\*], Lexicon shall deliver to Schering-Plough an invoice for Biotherapeutics Research Program Costs, pursuant to an agreed upon budget (and, to the extent applicable, Target Function Discovery Program Costs), if any, for such [\*\*]. Schering-Plough shall pay Lexicon the invoiced amount within [\*\*] of the receipt of the invoice therefor. Lexicon shall keep complete and accurate records in sufficient detail to properly reflect all Biotherapeutics Research Program Costs (and, to the extent applicable, Target Function Discovery Program Costs).

10.3 Milestone Payments with Respect to Collaboration Products. Schering-Plough shall pay to Lexicon the following milestone payments for each Collaboration Product to achieve the specified milestone:

<b>Milestone Event</b>	<b>Payment Amount (U.S. Dollars)</b>
Selection of Collaboration Product for Development	\$ [**]
Commencement of the first Phase 1 Clinical Trial	\$ [**]
Commencement of the first Phase 2 Clinical Trial	\$ [**]
Commencement of the first Phase 3 Clinical Trial	\$ [**]
First Regulatory Approval in the United States	\$ [**]
First Regulatory Approval in a European Major Market Country	\$ [**]
<b>TOTAL:</b>	<b>\$ 39,000,000</b>

The milestone payments payable under this Section 10.3 shall be subject to the following conditions.

(a) For each Program Target for which a Collaboration Product is being Developed, only one (1) set of milestone payments indicated above shall be paid, upon the first achievement of such milestone, regardless of the number of Collaboration Products for that Program Target to achieve such milestones.

(b) If any milestone event for a Collaboration Product is achieved prior to or in the absence of the achievement of any preceding milestone event for such Collaboration Product (e.g., First Regulatory Approval in the United States for a Collaboration Product without a Phase 3 Clinical Trial) then, effective upon achievement of any such milestone event, all previously unpaid payments for any such preceding milestone event(s) shall also become due and payable.

Schering-Plough shall notify Lexicon of the occurrence of any milestone event with respect to a Collaboration Product within [\*\*] of the occurrence of such event and make the associated milestone payment within [\*\*] of receipt of an invoice for such payment. Milestone payments shall be non-refundable and shall not be credited against royalties payable to Lexicon under this Agreement.

#### 10.4 Royalties Payable with Respect to Collaboration Products.

10.4.1 Royalty Rates. Schering-Plough shall pay royalties on Net Sales of each Collaboration Product in the Field at the rates specified below:

<b>Cumulative Annual Net Sales in the Territory of a Collaboration Product in a Contract Year</b>	<b>Royalty Rate</b>
Up to U.S. \$[**]	[**]%
U.S. \$[**] to less than U.S. \$[**]	[**]%
U.S. \$[**] and Greater	[**]%

For example, if aggregate Net Sales of a Collaboration Product in the Territory for any Contract Year were U.S. \$[\*\*], then Schering-Plough would pay to Lexicon royalties of U.S. \$[\*\*] with respect to such Net Sales [\*\*].

10.4.2 Royalty Term. Royalties shall be payable, on a product-by-product and country-by-country basis, on Net Sales of Collaboration Products in the Field for the longer of (a) the term of any Patent Rights Controlled by a party with a Valid Claim Covering the composition of matter or therapeutic use of such Collaboration Product in such country, (b) the expiration of regulatory exclusivity for such Collaboration Product in such country, or (c) [\*\*] after the First Commercial Sale of such Collaboration Product in such country.

10.4.3 Royalty Reporting and Payment.

10.4.3.1 Royalty Reports. During the term of this Agreement following the First Commercial Sale of any Collaboration Product, Schering-Plough shall, within [\*\*] after each [\*\*], furnish to Lexicon a written [\*\*] report showing, on a product-by-product and country-by-country basis:

- (a) the Net Sales of each Collaboration Product during the reporting period;
  - (b) the royalties payable in United States dollars which shall have accrued hereunder in respect of such Net Sales;
  - (c) withholding taxes, if any, required by law to be deducted in respect of such royalties;
  - (d) the date of the First Commercial Sale of any Collaboration Products in any country during the reporting period;
- and
- (e) the exchange rates used in determining the amount of United States dollars payable hereunder.

Royalties payable on sales in countries other than the United States shall be calculated in accordance with the standard exchange rate conversion practices used by Schering-Plough for financial accounting purposes. If no royalty or payment is due for any royalty period hereunder, Schering-Plough shall so report. Schering-Plough shall keep, and shall require its (sub)licensees to keep (all in accordance with generally accepted accounting principles, consistently applied), complete and accurate records in sufficient detail to properly reflect all gross sales and Net Sales and to enable the royalties payable hereunder to be determined. Schering-Plough shall include in each agreement with each applicable (sub)licensee a provision requiring such (sub)licensee to make reports to Schering-Plough, to keep and maintain records of sales made pursuant to such agreement and to grant access to such records by Lexicon's independent certified public accountant to the same extent required of Schering-Plough under this Agreement.

10.4.3.2 Royalty Payment Terms. Royalty payments for each [\*\*] shall be due and payable at the time the applicable report under Section 10.4.3.1 for such [\*\*] shall be due.

10.4.4 Audits. Upon the written request of Lexicon, Schering-Plough shall permit an independent certified public accountant selected by Lexicon and acceptable to Schering-Plough, which acceptance shall not be unreasonably withheld, to have access, at reasonable times and during normal business hours, and under obligations of strict confidence under a secrecy agreement with Schering-Plough, to such records of Schering-Plough as may be reasonably necessary to verify the accuracy of the reports described herein, in respect of any fiscal year ending not more than [\*\*] prior to the date of such request. Each party shall use commercially reasonable efforts to schedule all such verifications within [\*\*] after Lexicon makes its written request. All such verifications shall be conducted not more than [\*\*]. The report of Lexicon's independent certified public accountant shall be made available to both parties. Subject to Schering-Plough's rights under Section 16.7, in the event Lexicon's independent certified public accountant concludes that additional amounts were owed to Lexicon for such period, the additional amounts shall be paid by Schering-Plough within [\*\*] of the date Lexicon delivers to Schering-Plough such independent certified public accountant's written report so concluding, unless such report contains demonstrable error. In the event Lexicon's independent certified public accountant concludes that there was an overpayment to Lexicon during such period, the overpayment shall be repaid by Lexicon within [\*\*] of the date Lexicon received such independent certified public accountant's written report so concluding, unless such report contains demonstrable error. The fees charged by such independent certified public accountant shall be paid by Lexicon unless such audit discloses an underpayment of more than [\*\*] of the amount due under this Agreement for the period in question, in which case Schering-Plough will bear the full cost of such audit. Lexicon agrees that all information subject to review under this Section 10.4.4 or under any agreement with a (sub)licensee of Schering-Plough is confidential and that Lexicon shall cause its independent certified public accountant to retain all such information in confidence. Lexicon's independent certified public accountant shall only report to Lexicon as to the computation of gross sales, Net Sales and royalties payable under this Agreement, and shall not disclose to Lexicon any other information of Schering-Plough or any of its (sub)licensees.

10.5 Milestone Payments with Respect to Reverted Products. Lexicon shall pay to Schering-Plough the following milestone payments for each Reverted Product to achieve the specified milestone:

<u>Milestone Event</u>	<u>Payment Amount (U.S. Dollars)</u>
First Regulatory Approval in the United States	\$ [**]
First Regulatory Approval in a European Major Market Country	\$ [**]

The milestone payments payable under this Section 10.5 shall be subject to the condition that, for each Reverted Target for which a Reverted Product is being Developed, only one (1) set of milestone payments indicated above shall be paid, upon the first achievement of such milestone, regardless of the number of Reverted Products for that Reverted Target to achieve such milestones. Lexicon shall notify Schering-Plough of the occurrence of any milestone event with respect to a Reverted Product within [\*\*] of the occurrence of such event and make the associated milestone payment within [\*\*] of receipt of an invoice for such payment. Milestone payments shall be non-refundable and shall not be credited against royalties payable to Schering-Plough under this Agreement.

10.6 Royalties Payable with Respect to Reverted Products.

10.6.1 Royalty Rates. Lexicon shall pay royalties on Net Sales of each Reverted Product in the Field at rates equal to [\*\*] of the rates set forth for Schering-Plough in Section 10.4.1.

10.6.2 Royalty Term. Royalties shall be payable, on a product-by-product and country-by-country basis, on Net Sales of Reverted Products in the Field for the longer of (a) the term of any Patent Rights Controlled by a party with a Valid Claim Covering the composition of matter or therapeutic use of such Reverted Product in such country, (b) the expiration of regulatory exclusivity for such Reverted Product in such country, or (c) [\*\*] after the First Commercial Sale of such Reverted Product in such country.

10.6.3 Royalty Reporting and Payment.

10.6.3.1 Royalty Reports. During the term of this Agreement following the First Commercial Sale of any Collaboration Product, Lexicon shall, within [\*\*] after each [\*\*], furnish to Schering-Plough a written [\*\*] report showing, on a product-by-product and country-by-country basis:



- (a) the Net Sales of each Reverted Product during the reporting period;
- (b) the royalties payable in United States dollars which shall have accrued hereunder in respect of such Net Sales;
- (c) withholding taxes, if any, required by law to be deducted in respect of such royalties;
- (d) the date of the First Commercial Sale of any Reverted Products in any country during the reporting period; and
- (e) the exchange rates used in determining the amount of United States dollars payable hereunder.

Royalties payable on sales in countries other than the United States shall be calculated in accordance with the standard exchange rate conversion practices used by Lexicon for financial accounting purposes. If no royalty or payment is due for any royalty period hereunder, Lexicon shall so report. Lexicon shall keep, and shall require its (sub)licensees to keep (all in accordance with generally accepted accounting principles, consistently applied), complete and accurate records in sufficient detail to properly reflect all gross sales and Net Sales and to enable the royalties payable hereunder to be determined. Lexicon shall include in each agreement with each applicable (sub)licensee a provision requiring such (sub)licensee to make reports to Lexicon, to keep and maintain records of sales made pursuant to such agreement and to grant access to such records by Schering-Plough's independent certified public accountant to the same extent required of Lexicon under this Agreement.

10.6.3.2 Royalty Payment Terms. Royalty payments for each [\*\*] shall be due and payable at the time the applicable report under Section 10.6.3.1 for such [\*\*] shall be due.

10.6.4 Audits. Upon the written request of Schering-Plough, Lexicon shall permit an independent certified public accountant selected by Schering-Plough and acceptable to Lexicon, which acceptance shall not be unreasonably withheld, to have access, at reasonable times and during normal business hours, and under obligations of strict confidence under a secrecy agreement with Lexicon, to such records of Lexicon as may be reasonably necessary to verify the accuracy of the reports described herein, in respect of any fiscal year ending not more than [\*\*] prior to the date of such request. Each party shall use commercially reasonable efforts to schedule all such verifications within [\*\*] after Schering-Plough makes its written request. All such verifications shall be conducted not more than [\*\*]. The report of Schering-Plough's independent certified public accountant shall be made available to both parties. Subject to Lexicon's rights under Section 16.7, in the event Schering-Plough's independent certified public accountant concludes that additional amounts were owed to Schering-Plough for such period, the additional amounts shall be paid by Lexicon within [\*\*] of the date Schering-Plough delivers to Lexicon such independent certified public accountant's written report so concluding, unless such report contains demonstrable error. In the event Schering-Plough's independent certified public accountant concludes that there was an overpayment to Schering-Plough during such period, the overpayment shall be repaid by Schering-Plough within [\*\*] of the date Schering-Plough received such independent certified public accountant's written report so concluding, unless such report contains demonstrable error. The fees charged by such independent certified public accountant shall be paid by Schering-Plough unless such audit discloses an underpayment of more than [\*\*] of the amount due under this Agreement for the period in question, in which case Lexicon will bear the full cost of such audit. Schering-Plough agrees that all information subject to review under this Section 10.6.4 or under any agreement with a (sub)licensee of Lexicon is confidential and that Schering-Plough shall cause its independent certified public accountant to retain all such information in confidence. Schering-Plough's independent certified public accountant shall only report to Schering-Plough as to the computation of gross sales, Net Sales and royalties payable under this Agreement, and shall not disclose to Schering-Plough any other information of Lexicon or any of its (sub)licensees.

10.7 Withholding Taxes. In the event that any royalties due to a party are subject to withholding tax required by law to be paid to the taxing authority of any foreign country, the amount of such tax may be withheld from the applicable royalties due such party. The party owing such royalties shall promptly pay such tax on behalf of the party due such royalties and shall furnish such party with a certificate of withholding tax so deducted for such party's avoidance of duplicate taxation in multiple countries. Neither party may deduct any other withholding or any other governmental charges from the payments agreed upon under this Agreement, except to the extent same are paid on behalf of, or for the benefit of, the other party. Each party shall maintain official receipts of payment of any such withholding taxes and shall forward such receipts to the other party.

10.8 Blocked Currency. If by law, regulation, or fiscal policy of a particular country, conversion into United States dollars or transfer of funds of a convertible currency to the United States is restricted or forbidden, the party owing such payment shall give the other party prompt written notice and shall make such payment due under this Article 10 through such means or methods as are lawful in such country as the party owed such payment may reasonably designate. Failing the designation by the party owed such payment of such lawful means or methods within [\*\*] after such written notice is given to such party, the other party shall deposit such royalty payment in local currency to the credit of the party owed such payment in a recognized banking institution designated by such party, or if none is designated by such party within the [\*\*] period described above, in a recognized banking institution selected by the party owing such payment and identified in a written notice to the other party, and such deposit shall fulfill all obligations of the party owing such payment to the other party with respect to such payment.

10.9 Interest on Late Payments. A party shall have the right to seek to collect interest on any payments owed to such party that are not paid on or before [\*\*] after the date such payments are due under this Agreement at a rate equal to [\*\*], provided, however, if the failure to pay continues for more than [\*\*] after receipt of written notice of delinquency, then the applicable interest rate shall be [\*\*], calculated on the total number of days payment is delinquent. The party to which interest is owed shall send a written notice to the delinquent party notifying it of any such delinquency; *provided*, that such party shall not be required to send more than two (2) such notices in any Contract Year and; *provided, further*, that the date of delivery of such notice shall not affect the calculation of the amount of interest owed hereunder.

10.10 Manner of Payment. Except as provided in Section 10.8, payments to be made by a party under this Agreement shall be payable in United States dollars and shall be paid by bank wire transfer in immediately available funds to such bank account in the state and country in which the receiving party's principal office is located as is designated in writing by such party from time to time.

## ARTICLE 11. INTELLECTUAL PROPERTY

### 11.1 Ownership of Intellectual Property.

11.1.1 Ownership by Lexicon of the Lexicon Background Materials and Lexicon Background Technology. Subject to the rights and licenses granted under this Agreement, Lexicon (and its licensors, as applicable) shall own and retain all rights to the Lexicon Background Materials and Lexicon Background Technology.

11.1.2 Ownership by Schering-Plough of the Schering-Plough Background Materials and Schering-Plough Background Technology. Subject to the rights and licenses granted under this Agreement, Schering-Plough (and its licensors, as applicable) shall own and retain all rights to the Schering-Plough Background Materials and Schering-Plough Background Technology.

### 11.1.3 Ownership of Program Intellectual Property.

11.1.3.1 Inventorship. Inventorship for patentable inventions and discoveries conceived or reduced to practice during the course of the performance of activities pursuant to this Agreement shall be determined in accordance with U.S. patent laws for determining inventorship. In the event of a dispute regarding inventorship, if the parties are unable to resolve such inventorship dispute, the Joint Management Committee shall establish a procedure to resolve such dispute, that may include engaging a Third Party patent attorney jointly selected by the parties to resolve such dispute, which resolution by such patent attorney shall be binding upon the parties.

11.1.3.2 Ownership of Program Technology and Program Intellectual Property. Title to all Program Technology and Program Intellectual Property shall be based upon the inventorship for such Program Technology and Program Intellectual Property. To the extent either party has assigned to the other party, under the terms of the Predecessor Agreement, an undivided joint interest in any invention made solely by employees, agents, consultants or contractors of such party and its Affiliates, the party receiving such assignment shall re-assign such interest to the party making such assignment. Each party shall promptly disclose to the other party any inventions within the Program Technology and Program Intellectual Property made by such party's Affiliates, employees, agents or consultants.

### 11.2 Prosecution and Maintenance of Program Patent Rights.

11.2.1 Primary Prosecution Rights. The responsibility for (a) preparing, filing and prosecuting patent applications (including, but not limited to, provisional, reissue, continuing, continuation, continuation-in-part, divisional, and substitute applications and any foreign counterparts thereof) covering inventions within the Program Technology and Program Intellectual Property; (b) maintaining any Program Patent Rights; and (c) managing any interference or opposition or similar proceedings relating to the foregoing ((a) through (c), collectively, "Patent Prosecution") shall be the responsibility of the owner of such inventions determined in accordance with Section 11.1; *provided* that the Joint Management Committee shall determine which of the parties shall be responsible for Patent Prosecution with respect to inventions jointly owned by the parties, taking into account, among other factors, the nature of the claimed subject matter, the relative contribution of each party to the claimed subject matter and the relatedness of the claimed subject matter to that in other patent applications being prosecuted by the parties. Notwithstanding the foregoing, the party holding an exclusive license under Sections 8.1 and 8.2 to Program Patent Rights covering a Program Antibody, Program Antisense Compound, Program Protein or Collaboration Product or Reverted Product that incorporates or is derived from any Program Antibody, Program Antisense Compound or Program Protein shall be responsible for Patent Prosecution with respect to such Program Patent Rights. All decisions related to (y) [\*\*] or (z) [\*\*], shall be the responsibility of the party responsible for Patent Prosecution.

11.2.2 Secondary Prosecution Rights. If the prosecuting party elects not to continue pursuing Patent Prosecution for an invention within the Program Technology and Program Intellectual Property (and the other party has joint ownership of or a license under such Program Patent Rights pursuant to this Agreement), then the prosecuting party shall notify the other party in writing of such election at least [\*\*] prior to the last available date for action to preserve such Program Patent Rights. If such other party elects to continue Patent Prosecution, it will not be liable to the other party in any way with respect to its handling of, or the results obtained from, such Patent Prosecution. The other party will provide the party taking over Patent Prosecution with such assistance and execute such documents as are necessary to continue or permit such Patent Prosecution.

11.2.3 Right of Review. The prosecuting party under Sections 11.2.1 or 11.2.2 shall provide the other party with a reasonable opportunity to review and provide substantive input to material decisions relating to Patent Prosecution. The prosecuting party shall furnish to the other party copies of any substantive actions prepared for the U.S. Patent and Trademark Office or its foreign counterparts that may materially affect the Program Patent Rights being prosecuted or maintained reasonably in advance of the filing of such action in order to provide such party with a meaningful opportunity to comment thereon. Such action filed by the prosecuting party shall reflect any comments received from the other party that are received in a reasonably timely manner and are reasonably directed to maximizing the legal coverage of the claims of such Program Patent Rights being prosecuted or maintained.

11.2.4 Patent Prosecution Costs. All Patent Prosecution expenses, including attorneys' fees, incurred in the performance of Patent Prosecution under Section 11.2.1 or 11.2.2 shall be the responsibility of the prosecuting party.

11.2.5 Cooperation. Each party hereby agrees:

- (a) to take all reasonable additional actions and execute such agreements, instruments and documents as may be reasonably required to perfect the other's ownership interest in accordance with the intent of this Agreement, including, without limitation, requiring inventors to make appropriate patent assignments;
- (b) to make its employees, Affiliates, agents, independent contractors and consultants reasonably available to the other party (or to the other party's authorized attorneys, agents or representatives), to the extent reasonably necessary to enable the prosecuting party to undertake Patent Prosecution;
- (c) to provide the other party with copies of all material correspondence with the U.S. Patent and Trademark Office or its foreign counterparts related to Patent Prosecution;

(d) to cooperate, if necessary and appropriate, with the other party in gaining patent term extensions wherever applicable to Program Patent Rights for Program Inventions; and

(e) to endeavor in good faith to coordinate its efforts with the other party to minimize or avoid interference with the Patent Prosecution of the other party's patent applications related to inventions within the Program Technology and Program Intellectual Property.

11.3 Patent Term Extension. Each party shall cooperate with the other in obtaining patent term extension or supplemental protection certificates or their equivalents in any country with respect to the Program Patent Rights.

11.4 Enforcement of the Program Patent Rights.

11.4.1 Notices of Third Party Infringement. Each party shall promptly provide the other party with written notice reasonably detailing any known or alleged infringement of Program Patent Rights by a Third Party.

11.4.2 Hatch-Waxman Notifications. Each party shall provide to the other party copies of any allegations of alleged patent invalidity, unenforceability or non-infringement of a patent or patents with respect to Program Technology, Program Materials or Collaboration Products pursuant to a Paragraph IV Patent Certification by a Third Party filing an Abbreviated New Drug Application (*i.e.*, an action under the Hatch-Waxman Act). Such copies shall be provided promptly after receipt of such certification.

11.4.3 Other Notifications. Each party shall provide to the other party copies of any notices it receives from Third Parties regarding any patent nullity actions, any declaratory judgment actions, any alleged infringement of Program Patent Rights or any alleged misappropriation of intellectual property with respect to Program Technology, Program Materials or Collaboration Products. Such copies shall be provided promptly following receipt thereof.

11.4.4 Product-Related Infringement.

11.4.4.1 Schering-Plough shall have the first right, but not the obligation, to institute and direct legal proceedings against any Third Party believed to be infringing the Program Patent Rights of either party by the manufacture, use, importation, offer for sale or sale of a product competitive with a Collaboration Product (whether a clinical or commercial product). Lexicon shall have the first right, but not the obligation, to institute and direct legal proceedings against any Third Party believed to be infringing the Program Patent Rights of either party by the manufacture, use, importation, offer for sale or sale of a product competitive with a Reverted Product (whether a clinical or commercial product). Each party will bear its own costs, including attorneys' fees, relating to such legal proceedings; *provided* that the party instituting such proceedings shall bear the other party's out-of-pocket expenses, including attorneys' fees, incurred in complying with requests for cooperation made by the first such party. Any recovery in connection with such suit or proceeding will first be applied to reimburse the parties for their out-of-pocket expenses, including attorneys' fees. All recoveries resulting from such legal proceedings that are in excess of the parties' costs of bringing or participating in such action, including attorneys' fees, shall be shared equally by Lexicon and Schering-Plough.

11.4.4.2 If the relevant party elects not to institute and direct legal proceedings against any Third Party believed to be infringing the Program Patent Rights of either party as described in Section 11.4.4.1, the other party shall have the right, but not the obligation, to institute and direct such legal proceedings. Each party will bear its own costs, including attorneys' fees, relating to such legal proceedings; *provided* that the party instituting such proceedings shall bear the other party's out-of-pocket expenses, including attorneys' fees, incurred in complying with requests for cooperation made by the first such party. Any recovery in connection with such suit or proceeding will first be applied to reimburse the parties for their out-of-pocket expenses, including attorneys' fees. All recoveries resulting from such legal proceedings that are in excess of the parties' costs of bringing or participating in such action, including attorneys' fees, shall be shared equally by Lexicon and Schering-Plough.

11.4.4.3 In the event that a party takes action under this Section 11.4.4, the other party shall cooperate to the extent reasonably necessary at the sole expense of the party taking such action. Upon the reasonable request of the party taking such action, the other party shall join the suit and shall be represented in any such legal proceedings using counsel of its own choice. Neither party shall settle or otherwise agree to the final disposition of any claim or proceeding relating to Program Patent Rights Controlled in whole or in part by the other party or licensed under this Agreement to the other party without the prior written consent of such other party, which consent shall not be unreasonably withheld.

11.4.5 Non-Product-Related Infringement. Each party shall have the right, but not the obligation, to institute and direct legal proceedings against any Third Party believed to be infringing the Program Patent Rights solely owned by such party other than infringement relating to a Collaboration Product. All costs, including attorneys' fees, relating to such legal proceedings shall be borne by the party instituting such legal proceedings, and all recoveries resulting from such legal proceedings shall be retained by such party. The parties shall consult with each other regarding the institution, prosecution and control of any action or proceeding with respect to infringement of any of the Program Patent Rights jointly owned by the parties other than infringement relating to a Collaboration Product.

#### 11.5 Notices of Other Proceedings.

11.5.1 Each party shall notify the other in writing of any allegations it receives from a Third Party that the manufacture, use, sale, offer for sale or import of Program Technology, Program Materials or any Collaboration Product infringes the intellectual property rights of such Third Party. Such notice shall be provided promptly following receipt of such allegations.

11.5.2 In the event that a party receives notice that it or any of its Affiliates have been individually named as a defendant in a legal proceeding by a Third Party alleging infringement of a Third Party patent or other intellectual property right as a result of the manufacture, use, sale, offer for sale or import of Program Technology, Program Materials or a Collaboration Product, such party shall immediately notify the other party in writing after the receipt of such notice. Such written notice shall include a copy of any summons or complaint (or the equivalent thereof) received regarding the foregoing.

## ARTICLE 12. CONFIDENTIALITY

### 12.1 Nondisclosure Obligations.

12.1.1 General. Except as otherwise provided in this Article 12, during the term of this Agreement and for a period of five (5) years thereafter, each Receiving Party shall maintain the Confidential Information of each Disclosing Party in confidence and use it only for purposes specifically authorized under this Agreement.

12.1.2 Limitations. To the extent it is reasonably necessary or appropriate to fulfill its obligations or exercise its rights under this Agreement and subject to advance written notification to the Disclosing Party: (a) a party may disclose to Third Parties Confidential Information it is otherwise obligated not to disclose under this Section 12.1, to its Affiliates, (sub)licensees, consultants, outside contractors and clinical investigators, on a strict need-to-know basis for the purposes contemplated by this Agreement and on condition that such entities or persons agree to keep the Confidential Information confidential for the same time periods and to the same extent as such party is required to keep the Confidential Information confidential hereunder; and (b) a party or its (sub)licensees may disclose, using appropriate measures to preserve confidentiality, such Confidential Information to government or other regulatory authorities to the extent that such disclosure is reasonably necessary to obtain authorizations to conduct clinical trials of, and to commercially market, Collaboration Products pursuant to this Agreement. Furthermore, a Receiving Party may request permission from the Disclosing Party to disclose such Confidential Information to the extent that such disclosure is reasonably necessary to [\*\*].

12.1.3 Required Disclosure. A Receiving Party may disclose Confidential Information pursuant to interrogatories, requests for information or documents, subpoenas, civil investigative demands that are issued by a competent court or governmental agency or as otherwise clearly and specifically required by Law; *provided, however*, that the Receiving Party shall notify the Disclosing Party promptly upon receipt thereof, giving [\*\*] the Disclosing Party sufficient advance notice to permit it to oppose, limit or seek confidential treatment for such disclosure; and *provided, further*, that the Receiving Party shall furnish only that portion of the Confidential Information which it is advised by counsel is legally required whether or not a protective order or other similar order is obtained by the Disclosing Party.

12.2 Injunctive Relief. The parties hereto understand and agree that remedies at law may be inadequate to protect against any breach of any of the provisions of this Article 12 by either party or its employees, agents, officers or directors or any other person acting in concert with it or on its behalf. Accordingly, each party shall be entitled to the granting of injunctive relief by a court of competent jurisdiction against any action that constitutes any such breach of this Article 12.

12.3 Publication. Schering-Plough and Lexicon (each, a "Submitting Party") may each publish or present data and results relating to a Collaboration Product or Reverted Product for which the Submitting Party holds a commercial license under Section 8.2 hereof, subject to the prior review of the proposed disclosure by the other party (each, a "Reviewing Party"), solely to determine (a) whether the proposed disclosure contains the Confidential Information of the Reviewing Party or (b) whether the information contained in the proposed disclosure should be the subject of a patent application to be filed by the Reviewing Party prior to such disclosure. Each Submitting Party shall provide the Reviewing Party with the opportunity to review any proposed abstract, manuscript or presentation by delivering a copy thereof to the Reviewing Party no less than [\*\*] before its intended submission for publication or presentation. The Reviewing Party shall have [\*\*] from its receipt of any such abstract, manuscript or presentation in which to notify the Submitting Party in writing of any specific objections to the disclosure, based on either the need to seek patent protection or concern regarding the specific disclosure of the Confidential Information of the Reviewing Party. In the event the Reviewing Party objects to the disclosure, the Submitting Party agrees not to submit the publication or abstract or make the presentation containing the objected-to information until the Reviewing Party is given a reasonable additional period of time (not to exceed an additional [\*\*]) to seek patent protection for any material in the disclosure which the Reviewing Party believes is patentable or, in the case of Confidential Information, to allow the Submitting Party to delete any Confidential Information of the Reviewing Party from the proposed disclosure. The Submitting Party agrees to delete from the proposed disclosure any Confidential Information of the Reviewing Party upon request.

**ARTICLE 13. REPRESENTATIONS AND WARRANTIES**

13.1 Representations, Warranties and Covenants of Lexicon. Lexicon represents and warrants to and covenants with Schering-Plough that:

13.1.1 Lexicon is a corporation duly organized, validly existing and in corporate good standing under the laws of the State of Delaware;

13.1.2 Lexicon has the corporate and legal right, authority and power to enter into this Agreement, and to extend the rights and licenses granted to Schering-Plough in this Agreement;

13.1.3 Lexicon has taken all necessary action to authorize the execution, delivery and performance of this Agreement;

13.1.4 upon the execution and delivery of this Agreement, this Agreement shall constitute a valid and binding obligation of Lexicon, enforceable in accordance with its terms, except as enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' and contracting parties' rights generally and except as enforceability may be subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law);

13.1.5 the performance of Lexicon's obligations under this Agreement will not conflict with its charter documents or result in a breach of any agreements, contracts or other arrangements to which it is a party;

13.1.6 Lexicon will not during the term of this Agreement enter into any agreements, contracts or other arrangements that would be inconsistent with its obligations under this Agreement; and

13.1.7 To the best of Lexicon's knowledge after reasonable inquiry, Lexicon is not aware of any patent or other intellectual property rights of any Third Party that would be infringed by its conduct of the Target Function Discovery Program, and has received no notice from any Third Party claiming any such infringement.

13.2 Representations, Warranties and Covenants of Schering-Plough. Schering-Plough represents and warrants to and covenants with Lexicon that:

13.2.1 SPRI, Organon and Intervet are registered companies duly organized, validly existing and in good standing under the laws of the jurisdiction under which they were organized;



13.2.2 Schering-Plough has the corporate and legal right, authority and power to enter into this Agreement, and to extend the rights and licenses granted to Lexicon in this Agreement;

13.2.3 Schering-Plough has taken all necessary action to authorize the execution, delivery and performance of this Agreement;

13.2.4 upon the execution and delivery of this Agreement, this Agreement shall constitute a valid and binding obligation of Schering-Plough enforceable in accordance with its terms, except as enforceability may be limited by applicable bankruptcy, insolvency, reorganization, moratorium or similar laws affecting creditors' and contracting parties' rights generally and except as enforceability may be subject to general principles of equity (regardless of whether such enforceability is considered in a proceeding in equity or at law);

13.2.5 the performance of its obligations under this Agreement will not conflict with the charter documents or SPRI, Organon or Intervet or result in a breach of any agreements, contracts or other arrangements to which any of them is a party; and

13.2.6 Schering-Plough will not after the Effective Date enter into any agreements, contracts or other arrangements that would be inconsistent with its obligations under this Agreement.

13.3 Warranty Disclaimer. EXCEPT AS OTHERWISE EXPRESSLY PROVIDED IN THIS AGREEMENT, NEITHER PARTY MAKES ANY WARRANTY WITH RESPECT TO ANY PRODUCT, PATENT RIGHTS, GOODS, SERVICES, BACKGROUND MATERIALS OR ANY OTHER SUBJECT MATTER OF THIS AGREEMENT, AND EACH PARTY HEREBY DISCLAIMS WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE AND NON-INFRINGEMENT WITH RESPECT TO ANY AND ALL OF THE FOREGOING. IN ADDITION, THE PARTIES ACKNOWLEDGE THAT THE GENERATION OR USE OF BACKGROUND MATERIALS MAY BE COVERED BY ONE OR MORE VALID PATENTS OF THIRD PARTIES. EACH PARTY ACKNOWLEDGES THAT EXERCISE BY IT OF THE RIGHTS AND LICENSES GRANTED TO IT PURSUANT TO ARTICLE 8 HEREOF MAY BE COVERED BY ONE OR MORE VALID PATENTS OF THIRD PARTIES.

13.4 Limited Liability. EXCEPT AS SPECIFICALLY SET FORTH IN THIS AGREEMENT, NEITHER LEXICON NOR SCHERING- PLOUGH WILL BE LIABLE WITH RESPECT TO ANY MATTER ARISING UNDER THIS AGREEMENT UNDER ANY CONTRACT, NEGLIGENCE, STRICT LIABILITY OR OTHER LEGAL OR EQUITABLE THEORY FOR ANY PUNITIVE, EXEMPLARY, INCIDENTAL OR CONSEQUENTIAL DAMAGES OR LOST PROFITS.

#### ARTICLE 14. INDEMNITY

14.1 Lexicon Indemnity Obligations. Lexicon agrees to defend, indemnify and hold Schering-Plough, its Affiliates and their respective employees and agents harmless from all claims, losses, damages or expenses (including reasonable attorneys' fees and costs of litigation) arising as a result of: (a) actual or asserted violations of any applicable law or regulation by Lexicon, its (sub)licensees and their respective Affiliates by virtue of which any Reverted Products manufactured, distributed or sold by Lexicon hereunder shall be alleged or determined to be adulterated, misbranded, mislabeled or otherwise not in compliance with any applicable law or regulation; (b) claims for bodily injury, death or property damage attributable to the manufacture, distribution, sale or use of any Reverted Products by Lexicon, its (sub)licensees and their respective Affiliates; (c) a recall of a Reverted Product manufactured, distributed or sold by Lexicon hereunder ordered by a governmental agency or required by a confirmed Reverted Product failure as reasonably determined by the parties hereto; or (d) Lexicon's breach of any of its representations, warranties or covenants hereunder.

14.2 Schering-Plough Indemnity Obligations. Schering-Plough agrees to defend, indemnify and hold Lexicon, its Affiliates and their respective employees and agents harmless from all claims, losses, damages or expenses (including reasonable attorneys' fees and costs of litigation) arising as a result of: (a) actual or asserted violations of any applicable law or regulation by Schering-Plough, its (sub)licensees and their respective Affiliates by virtue of which any Collaboration Products manufactured, distributed or sold by Schering-Plough hereunder shall be alleged or determined to be adulterated, misbranded, mislabeled or otherwise not in compliance with any applicable law or regulation; (b) claims for bodily injury, death or property damage attributable to the manufacture, distribution, sale or use of any Collaboration Products by Schering-Plough, its (sub)licensees and their respective Affiliates; (c) a recall of an Collaboration Product manufactured, distributed or sold by Schering-Plough hereunder ordered by a governmental agency or required by a confirmed Collaboration Product failure as reasonably determined by the parties hereto; or (d) Schering-Plough's breach of any of its representations, warranties or covenants hereunder.

14.3 Limitation on Indemnity Obligations. Neither party, its Affiliates or their respective employees and agents shall be entitled to the indemnities set forth in Sections 14.1 or 14.2, respectively, to the comparative extent the claim, loss, damage or expense for which indemnification is sought was caused by a grossly negligent, reckless or intentional act or omission by such party, its directors, officers, employees or authorized agents.

14.4 Procedure. If a party or any of its Affiliates or their respective employees or agents (collectively, the "Indemnitee") intends to claim indemnification under this Article 14, the Indemnitee shall promptly notify the other party (the "Indemnitor") of any loss, claim, damage, liability or action in respect of which the Indemnitee intends to claim such indemnification, and the Indemnitor shall assume the defense thereof with counsel selected by the Indemnitor and reasonably acceptable to the Indemnitee, provided, however, that an Indemnitee shall have the right to retain its own counsel, with the fees and expenses to be paid by the Indemnitee, if representation of such Indemnitee by the counsel retained by the Indemnitor would be inappropriate due to actual or potential differing interests between such Indemnitee and any other party represented by such counsel in such proceedings. The Indemnitor shall have the right to settle or compromise any claims for which it is providing indemnification under this Article 14, provided that the consent of the Indemnitee (which shall not be unreasonably withheld or delayed) shall be required in the event any such settlement or compromise would adversely affect the interests of the Indemnitee. The indemnity agreement in this Article 14 shall not apply to amounts paid in settlement of any loss, claim, damage, liability or action if such settlement is effected without the consent of the Indemnitor. The failure to deliver notice to the Indemnitor within a reasonable time after the commencement of any such action, if prejudicial to the Indemnitor's ability to defend such action, shall relieve such Indemnitor of any liability to the Indemnitee under this Article 14, but the omission so to deliver notice to the Indemnitor will not relieve it of any liability that it may have to any Indemnitee otherwise than under this Article 14. The Indemnitee under this Article 14, its employees and agents, shall cooperate fully with the Indemnitor and its legal representatives in the investigation of any action, claim or liability covered by this indemnification.

14.5 Insurance. Schering-Plough and Lexicon shall maintain appropriate product liability insurance or maintain adequate self-insurance reserves with respect to Development, manufacture and Commercialization of Collaboration Products and Reverted Products, respectively, by such party in such amount as such party customarily maintains with respect to sales of its other products. Each party shall maintain such insurance for so long as it continues to manufacture or sell Collaboration Products or Reverted Products, as applicable, and thereafter for so long as such party customarily maintains insurance with respect to sales of its other products.

## ARTICLE 15. EXPIRATION AND TERMINATION

15.1 Term of Agreement. The term of this Agreement shall commence on the Effective Date and shall continue until the earlier of (a) the time, if applicable, that all Program Targets have become Released Targets, and (b) on a product-by-product and country-by-country basis, the expiration of the royalty term with respect to the relevant Collaboration Product or Reverted Product in such country under Section 10.4.2 or 10.6.2, as applicable.

15.2 Events of Default. An "Event of Default" by either party mean any of the following events: (a) the occurrence of a breach of a material obligation under this Agreement (including, without limitation, the diligence obligations of the parties under Sections 9.1 and 9.4, respectively) if such party fails to remedy such breach within [\*\*] after written notice thereof by the non-breaching party ([\*\*] in the event of a party's failure to make a payment required hereunder) or, if remediation of such breach in [\*\*] is not practicable, if such party fails to commence and diligently pursue such remediation during such [\*\*] period, or (b) the commencement of any proceeding in or for bankruptcy, insolvency, dissolution or winding up by or against such party that is not dismissed or otherwise disposed of within [\*\*] thereafter.

15.3 Effect of an Event of Default. In the event of an Event of Default, the non-defaulting party shall have the right, at its option exercisable in its sole discretion, in addition to any other rights or remedies available to it at law or in equity and subject to the limitations set forth in Sections 3.7.2, 13.4 and 16.7 hereof (and except as provided in Sections 9.2 and 9.4), to terminate this Agreement upon [\*\*] notice thereof to the other party, in which case (a) the licenses granted to the defaulting party pursuant to Article 8 shall terminate and (b) the defaulting party shall return to the non-defaulting party or, upon the non-defaulting party's option, destroy all information, materials or documentation provided by the non-defaulting party pursuant to this Agreement; *provided* that such termination shall apply to the rights and licenses granted to the defaulting party under Sections 8.1 and 8.2 with respect to a Collaboration Product or Reverted Product only in the event, and to the extent, that such Event of Default relates to such specific Collaboration Product or Reverted Product. For the avoidance of doubt, the termination rights of the non-defaulting party under this Section 15.3 shall be in addition to any other rights or remedies available to it at law or in equity. The rights and licenses granted to the defaulting party under Sections 8.1 and 8.2 with respect to any Collaboration Product or Reverted Product with respect to which no Event of Default has occurred shall, subject to such party's applicable obligations under this Agreement with respect thereto, continue. In the event that this Agreement is terminated pursuant to this Section 15.3, the defaulting party's obligations under the exclusivity provisions set forth in Section 2.4 shall survive for five (5) years following such termination.

15.4 Effect of Expiration or Termination of Agreement. The expiration or termination of this Agreement shall not relieve the parties of any obligation accruing prior to such expiration or termination. The provisions of Articles 11, 12 and 14 and Sections 16.2 through 16.6 hereof shall survive the expiration or termination of this Agreement. The rights and licenses granted to the non-defaulting party under Sections 8.1 and 8.2 hereof shall survive any termination of this Agreement by such non-defaulting party pursuant to Section 15.3. The provisions of Sections 10.3 through 10.8 hereof shall survive any termination of this Agreement under which Schering-Plough, its (sub)licensees or their respective Affiliates retains the right to sell Collaboration Products until such time as this Agreement would have expired with respect to any Collaboration Product, as the case may be, in any country pursuant to Section 15.1 hereof had this Agreement not been earlier terminated.

## ARTICLE 16. MISCELLANEOUS

16.1 Force Majeure. Neither party shall be held liable or responsible to the other party nor be deemed to have defaulted under or breached this Agreement for failure or delay in fulfilling or performing any obligation under this Agreement when such failure or delay is caused by or results from causes beyond the reasonable control of the affected party, including but not limited to fire, floods, embargoes, war, acts of war (whether war is declared or not), insurrections, riots, civil commotions, strikes, lockouts or other labor disturbances, acts of God or acts, omissions or delays in acting by any governmental authority; *provided, however*, that the party so affected shall use reasonable commercial efforts to avoid or remove such causes of nonperformance, and shall continue performance hereunder with reasonable dispatch whenever such causes are removed. Either party shall provide the other party with prompt written notice of any delay or failure to perform that occurs by reason of force majeure.

16.2 Assignment. This Agreement may not be assigned or otherwise transferred, in whole or in part, by either party without the consent of the other party; *provided, however*, that either Lexicon or Schering-Plough may, without such consent, assign its rights and obligations under this Agreement (a) to any Affiliate, or (b) in connection with a merger, consolidation or sale of such portion of a party's assets that includes rights under this Agreement to an unrelated Third Party; *provided, further*, that such party's rights and obligations under this Agreement shall be assumed by its successor in interest in any such transaction and shall not be transferred separate from all or substantially all of its other business assets, including those business assets that are the subject of this Agreement. Any purported assignment in violation of the preceding sentence shall be void. Any permitted assignee shall assume all obligations of its assignor under this Agreement, unless the parties otherwise agree.

### 16.3 Change of Control.

16.3.1 Change of Control of Schering-Plough. In the event that Schering-Plough or its parent corporation enters into a transaction with a Third Party that had revenues from the sale of pharmaceutical products, in the most-recently-completed calendar year preceding the date of the transaction, of at least ten billion dollars (\$10,000,000,000), which transaction results in such Third Party becoming the beneficial owner, directly or indirectly, of securities representing fifty percent (50%) or more of either (a) the then-outstanding shares of common stock of Schering-Plough or its parent corporation, or (b) the combined voting power of the then-outstanding voting securities of Schering-Plough or its parent corporation, this Agreement shall remain in full force and effect, *provided* that Schering-Plough or its Third Party successor shall have [\*\*] after such transaction, or [\*\*] after the Effective Date in the case of Merck & Co., Inc. as the successor, to designate a Program Target as a Released Target pursuant to Section 2.3 herein (subject to Lexicon's right, under Section 2.3, to designate such Program Target as a Reverted Target) because of an overlapping program at such Third Party successor.

16.3.2 Change of Control of Lexicon. In the event that Lexicon enters into a transaction with a Third Party that had revenues from the sale of pharmaceutical products, in the most-recently-completed calendar year preceding the date of the transaction, of at least ten billion dollars (\$10,000,000,000), which transaction results in such Third Party becoming the beneficial owner, directly or indirectly, of securities representing fifty percent (50%) or more of either (a) the then-outstanding shares of common stock of Lexicon, or (b) the combined voting power of the then-outstanding voting securities of Lexicon, this Agreement shall remain in full force and effect; *provided, however*, that any Joint Management Committee and Joint Research Committee in effect shall terminate immediately and Schering-Plough shall no longer be obligated to provide reports to Lexicon or its Third Party successor with respect to Schering-Plough's Biotherapeutics Research or Development efforts under Sections 2.2.4 or 6.3.

16.4 Severability. Each party hereby agrees that it does not intend to violate any public policy, statutory or common laws, rules, regulations, treaty or decision of any government agency or executive body thereof of any country or community or association of countries. Should one or more provisions of this Agreement be or become invalid, the parties hereto shall substitute, by mutual consent, valid provisions for such invalid provisions which valid provisions in their economic effect are sufficiently similar to the invalid provisions that it can be reasonably assumed that the parties would have entered into this Agreement with such valid provisions in lieu of such invalid provisions. In case such valid provisions cannot be agreed upon, the invalidity of one or several provisions of this Agreement shall not affect the validity of this Agreement as a whole, unless the invalid provisions are of such essential importance to this Agreement that it is to be reasonably assumed that the parties would not have entered into this Agreement without the invalid provisions.

16.5 Notices. Any consent, notice or report required or permitted to be given or made under this Agreement by one of the notification parties hereto to the other shall be in writing, delivered personally or by facsimile (and promptly confirmed by telephone, personal delivery or courier) or courier, postage prepaid (where applicable), addressed to such other party at its address indicated below, or to such other address as the addressee shall have last furnished in writing to the addressor and shall be effective upon receipt by the addressee.

If to Lexicon: Lexicon Pharmaceuticals, Inc.  
8800 Technology Forest Place  
The Woodlands, Texas 77381  
Attention: President and Chief Executive Officer  
Telephone: (281) 863-3000  
Facsimile: (281) 863-8095

With a copy to: Lexicon Pharmaceuticals, Inc.  
8800 Technology Forest Place  
The Woodlands, Texas 77381  
Attention: General Counsel  
Telephone: (281) 863-3000  
Facsimile: (281) 863-8010

If to Schering-Plough: Schering-Plough Research Institute  
2015 Galloping Hill Road  
Kenilworth, New Jersey 07033  
Attention: Executive Director,  
Discovery Collaborations  
Telephone: (908) 740-3290  
Facsimile: (908) 740-7164

With a copy to: Schering Corporation  
2000 Galloping Hill Road  
Kenilworth, New Jersey 07033  
Attention: Legal Department,  
Vice President, Licensing

All such communications shall be effective upon receipt.

16.6 Applicable Law. This Agreement shall be governed by and construed in accordance with the laws of the State of Delaware, United States of America, without reference to the conflicts of law principles thereof.

16.7 Dispute Resolution. Subject to Section 3.7.2, the parties hereby agree that they will first attempt in good faith to promptly resolve any controversy or claim arising out of or relating to this Agreement promptly by negotiations. If a controversy or claim should arise hereunder, the matter shall be referred to an individual designated by the Chief Executive Officer (or the equivalent position) of Lexicon and by the President (or the equivalent position) of Schering-Plough's research division (the "Representatives"). If the matter has not been resolved within [\*\*] of the first meeting of the Representatives of the parties (which period may be extended by written mutual agreement) concerning such matter, the parties shall be free to pursue all available recourse both at law and in equity.

16.8 Entire Agreement. This Agreement, together with the exhibits and appendices hereto, contains the entire understanding of the parties with respect to the subject matter hereof. All express or implied agreements and understandings, either oral or written, heretofore made are expressly merged in and made a part of this Agreement. This Agreement may be amended, or any term hereof modified, only by a written instrument duly executed by both parties hereto.

16.9 Publicity. The terms of this Agreement shall be treated as the Confidential Information of the parties and, except to the extent required by applicable Law, shall not be disclosed to anyone (except for the parties' respective employees, consultants, agents and attorneys assisting in the review and negotiation of this Agreement who have a need to know the terms of this Agreement) without the written permission of the other party. If either party desires to release a separate announcement relating to this Agreement, it shall first seek the other party's written approval by submitting a draft of such proposed announcement to the other party for review and comment; *provided* that such approval shall not be unreasonably withheld or delayed.

16.10 Headings. The captions to the several Articles and Sections hereof are not a part of this Agreement, but are merely guides or labels to assist in locating and reading the several Articles and Sections hereof.

16.11 No Partnership. It is expressly agreed that the relationship between Lexicon and Schering-Plough shall not constitute a partnership, joint venture or agency. Neither Lexicon nor Schering-Plough shall have the authority to make any statements, representations or commitments of any kind, or to take any action, which shall be binding on the other, without the prior consent of the other party to do so.

16.12 Exports. The parties acknowledge that the export of technical data, materials or products is subject to the exporting party receiving any necessary export licenses and that the parties cannot be responsible for any delays attributable to export controls which are beyond the reasonable control of either party. Lexicon and Schering-Plough agree not to export or re-export, directly or indirectly, any information, technical data, the direct product of such data, samples or equipment received or generated under this Agreement in violation of any applicable export control laws or governmental regulations. Lexicon and Schering-Plough agree to obtain similar covenants from their licensees, (sub)licensees, or corporate partners, as the case may be, and contractors with respect to the subject matter of this Section 16.12.

16.13 Waiver. The waiver by either party hereto of any right hereunder or the failure to perform or of a breach by the other party shall not be deemed a waiver of any other right hereunder or of any other breach or failure by said other party whether of a similar nature or otherwise.

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

[SIGNATURE PAGE FOLLOWS]

IN WITNESS WHEREOF, the parties have caused their duly authorized representatives to execute and deliver this Agreement as of the Effective Date.

**LEXICON PHARMACEUTICALS, INC.**

By \_\_\_\_\_  
Name \_\_\_\_\_  
Title \_\_\_\_\_

**SCHERING CORPORATION,**  
acting through its Schering-Plough  
Research Institute division

By \_\_\_\_\_  
Name \_\_\_\_\_  
Title \_\_\_\_\_

**N.V. ORGANON**

By \_\_\_\_\_  
Name \_\_\_\_\_  
Title \_\_\_\_\_

**INTERVET INC.**

By \_\_\_\_\_  
Name \_\_\_\_\_  
Title \_\_\_\_\_



**Exhibit 1.40**

**Level 1 Phenotypic Analysis**

Level 1 Phenotypic Analysis is an initial screen designed to identify primary characteristics resulting from selected mutations in Mutant Mice. Level 1 Phenotypic Analysis currently includes the following assays, which may be changed from time to time at the Joint Research Committee's reasonable scientific discretion.

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## Exhibit 1.41

### **Level 2 Phenotypic Analysis**

Level 2 Phenotypic Analysis is an advanced screen designed to provide more detailed and focused data relating to primary characteristics identified as a result of Level 1 Phenotypic Analysis. The Joint Research Committee may determine that Level 2 Phenotypic Analysis be performed for any one or more Therapeutic Area(s). Level 2 Phenotypic Analysis currently includes (a) assays previously performed for Level 1 Phenotypic Analysis with respect to such Therapeutic Area(s) (utilizing greater numbers of Mutant Mice) and (b) additional assays represented by those described below, which may be changed from time to time at the Joint Research Committee's reasonable scientific discretion.

#### **Metabolism and Endocrinology**

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#### **Cardiology**

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#### **Neurology**

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#### **Oncology**

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#### **Immunology**

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#### **Ophthalmology**

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## CERTIFICATIONS

I, Arthur T. Sands, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Lexicon Pharmaceuticals, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 7, 2010

/s/ Arthur T. Sands

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Arthur T. Sands, M.D., Ph.D.  
*President and Chief Executive Officer*

## CERTIFICATIONS

I, James F. Tessmer, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Lexicon Pharmaceuticals, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 7, 2010

/s/ James F. Tessmer

James F. Tessmer

*Vice President, Finance and Accounting*

**CERTIFICATION**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350, as adopted), Arthur T. Sands, M.D., Ph.D., Principal Executive Officer of Lexicon Pharmaceuticals, Inc. ("Lexicon"), and James F. Tessmer, Principal Financial Officer of Lexicon, each hereby certify that:

1. Lexicon's Quarterly Report on Form 10-Q for the period ended March 31, 2010, and to which this Certification is attached as Exhibit 32.1 (the "Periodic Report"), fully complies with the requirements of section 13(a) or section 15(d) of the Securities Exchange Act of 1934, and
2. The information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of Lexicon.

IN WITNESS WHEREOF, the undersigned have set their hands hereto as of the 7th day of May, 2010.

By: /s/ Arthur T. Sands  
Arthur T. Sands, M.D., Ph.D.  
*President and Chief Executive Officer*

By: /s/ James F. Tessmer  
James F. Tessmer  
*Vice President, Finance and Accounting*