DURECT CORP
Form 10-K
March 03, 2011
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 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: 000-31615

DURECT CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**94-3297098**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

2 Results Way

Cupertino, CA 95014

(Address of principal executive offices, including zip code)

Registrant s telephone number, including area code: (408) 777-1417

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock $0.0001 par value per share	**The NASDAQ Stock Market LLC**
Preferred Share Purchase Rights	**(NASDAQ Global Market)**

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ¨ NO x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 of the Act. YES ¨ NO x

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 than the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES x NO ¨

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of large accelerated filer and accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨	Accelerated filer x	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 Act). YES ¨ NO x

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately $199,532,318 as of June 30, 2010 based upon the closing sale price on the NASDAQ Global Market reported for such date. Shares of Common Stock held by each officer and director and by each person who may be deemed to be an affiliate have been excluded. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

There were 87,288,963 shares of the registrant s Common Stock issued and outstanding as of February 28, 2011.

DOCUMENTS INCORPORATED BY REFERENCE

Part III incorporates information by reference from the definitive Proxy Statement for the 2011 annual meeting of stockholders, which is expected to be filed not later than 120 days after the Registrant s fiscal year ended December 31, 2010.

Table of Contents

DURECT CORPORATION

ANNUAL REPORT ON FORM 10-K

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2010

TABLE OF CONTENTS

Table of Contents

PART I

Item 1. Business.

Overview

We are a specialty pharmaceutical company focused on the development of pharmaceutical products based on our proprietary drug delivery technology platforms. Our product pipeline currently consists of seven investigational drug candidates in clinical development, with one program the subject of a New Drug Application (NDA) with the U.S. Food and Drug Administration (FDA), one program in Phase III, two programs in Phase II and three programs in Phase I. The more advanced programs are all in the field of pain management and we believe that each of these targets large market opportunities with product features that are differentiated from existing therapeutics. We have other programs underway in fields outside of pain management, including several efforts underway which seek to improve the administration of biotechnology agents such as proteins and peptides.

A central aspect of our business strategy involves advancing multiple product candidates at one time, which is enabled by leveraging our resources with those of corporate collaborators. Thus, certain of our programs are currently licensed to corporate collaborators on terms which typically call for our collaborator to fund all or a substantial portion of future development costs and then pay us milestone payments based on specific development or commercial achievements plus a royalty on product sales. At the same time, we have retained the rights to other programs, which are the basis of future collaborations and over time may provide a pathway for us to develop our own commercial, sales and marketing organization.

Product Research and Development Programs

Our development efforts are focused on the application of our pharmaceutical systems technologies to potential products in a variety of chronic and episodic disease areas including pain, central nervous system (CNS) disorders, cardiovascular disease and other chronic diseases. Our more advanced product research and development efforts in these areas are set forth in the following table:

Product Candidate	Disease/Indication	Collaborator	Technology Platform	Stage
Remoxy (Oral controlled release oxycodone)	Chronic Pain	Pfizer/Pain Therapeutics (worldwide)	ORADUR	NDA resubmitted in response to a Complete Response Letter; June 23, 2011 PDUFA goal date
POSIDUR (Controlled release injection of bupivacaine)	Post Operative Pain	Hospira (U.S. and Canada); Nycomed (Europe and other defined territories); DURECT retains rights in Japan and other countries	SABER	Phase III (U.S.) Phase II (E.U.)
ELADUR (Transdermal bupivacaine)	Pain	Pfizer (worldwide)	TRANSDUR	Phase II
TRANSDUR-Sufentanil (Transdermal sufentanil)	Chronic Pain	DURECT retains worldwide rights	TRANSDUR	Phase II

NOTE: POSIDUR , SABER , TRANSDUR , ORADUR®, ELADUR , DURIN®, CHRONOGESIC®, MICRODUR , ALZET® and LACTEL® are trademarks of DURECT Corporation. Other trademarks referred to belong to their respective owners.

1

Table of Contents

Product Candidate	Disease/Indication	Collaborator	Technology Platform	Stage
ORADUR-based opioid (hydrocodone)	Pain	Pfizer/Pain Therapeutics (worldwide)	ORADUR	Phase I
ORADUR-based opioid (hydromorphone)	Pain	Pfizer/Pain Therapeutics (worldwide)	ORADUR	Phase I
ORADUR-ADHD	Attention Deficit Hyperactivity Disorder (ADHD)	Orient Pharma (defined Asian and South Pacific countries); DURECT retains rights in North America, Europe, Japan and all other countries	ORADUR	Phase I
ORADUR-based opioid (oxymorphone)	Pain	Pfizer/Pain Therapeutics (worldwide)	ORADUR	IND accepted by the FDA
Various	Biologics Programs/Research Programs in other Therapeutic Categories	DURECT retains worldwide rights, except for certain feasibility projects whereby our collaborator generally has an option on rights	SABER/DUROS/ DURIN	Preclinical/ Research Stage

Remoxy (ORADUR-Oxycodone)

Market Opportunity. Chronic pain is usually the result of an ongoing condition or significant problem associated with chronic diseases, including cancer, various neurological and skeletal disorders and other ailments such as severe arthritis or a debilitating back injury. As the condition gets worse, the pain often gets worse. Also, long-lasting pain can affect the nervous system to the point where pain persists even if the condition that originally caused the pain is stabilized or improved. This is one reason patients often need stronger pain medication even if their underlying condition has been treated. Chronic pain affects as many as 50 million Americans annually. OxyContin®, a brand name extended-release oral oxycodone-based painkiller, accounted for over $3.0 billion in worldwide sales in 2010.

Development Strategy. Remoxy is an oral, long-acting oxycodone gelatin capsule under development with Pain Therapeutics, Inc. (Pain Therapeutics) to which we have licensed exclusive, worldwide, development and commercialization rights under a development and license agreement entered into in December 2002. Subsequently, Pain Therapeutics has sublicensed the worldwide commercialization rights of Remoxy (except for Australia and New Zealand) to King Pharmaceuticals, Inc. (King) and, as of March 2009, we are working directly with King on further development of Remoxy. In February 2011, Pfizer Inc (Pfizer) acquired King and thereby assumed the rights and obligations of King with respect to Remoxy. Remoxy is formulated with our ORADUR technology and incorporates several abuse-deterrent properties with the convenience of twice-a-day dosing. Oxycodone is also the active drug ingredient in OxyContin®, a brand name extended-release oral painkiller, which achieved annual worldwide sales of greater than $3.0 billion in 2010. Under the agreement with Pain Therapeutics, subject to and upon the achievement of predetermined development and regulatory

Table of Contents

milestones, we are entitled to receive milestone payments of up to $9.3 million in the aggregate. As of December 31, 2010, we had received $1.7 million in cumulative milestone payments. We also receive reimbursement for our research and development efforts on Remoxy and a manufacturing profit on our supply of key product excipients for use in Remoxy. In addition, if commercialized, we will receive royalties for Remoxy and other licensed products which do not contain an opioid antagonist of between 6.0% to 11.5% of net sales depending on sales volumes.

Clinical Program. In December 2007, Pain Therapeutics and King announced that the pivotal Phase III trial for Remoxy successfully met its primary endpoint ($p<0.01$) that was prospectively defined by the FDA during the Special Protocol Assessment process. In addition, the study achieved statistically significant results in secondary endpoints such as Quality of Analgesia ($p<0.01$) and Global Assessment ($p<0.01$). Pain Therapeutics submitted an NDA for Remoxy to the FDA in June 2008, and in August 2008 the FDA accepted the NDA and granted priority review. In December 2008, Pain Therapeutics received a Complete Response Letter for its NDA for Remoxy in which the FDA determined that the NDA was not approved. According to Pain Therapeutics, the FDA indicated that additional non-clinical data would be required to support the approval of Remoxy, but the FDA has not requested or recommended additional clinical efficacy studies prior to approval. King assumed responsibility for further development of Remoxy from Pain Therapeutics in March 2009. In July 2009, King met with the FDA to discuss the Complete Response Letter. According to King and Pain Therapeutics, the outcome of that meeting provided King with a clearer path forward to resubmit the Remoxy NDA and to address all FDA comments in the Complete Response Letter. King resubmitted the NDA in December of 2010; this was a Class II resubmission and the FDA has indicated that it has set a June 23, 2011 Prescription Drug User Fee Act (PDUFA) goal date for Remoxy.

Additional ORADUR-Opioid Products in Development

During 2006, 2007, 2008 and 2010, we also worked with Pain Therapeutics and King on the development of three additional ORADUR abuse-resistant opioid drug candidates which would address the chronic pain market. Phase I clinical trials have been conducted for two of these ORADUR-based products (hydrocodone and hydromorphone), and an IND has been accepted by the FDA for the third ORADUR-based opioid (oxymorphone).

POSIDUR

Market Opportunity. According to data published by the Center for Disease Control and Prevention, there are approximately 72 million ambulatory and inpatient procedures performed annually in the U.S. Epidemiological studies indicate that up to 100% of surgical patients experience postoperative pain, with 50-75% reporting inadequate pain relief. The current standard of care for post-surgical pain includes oral opiate and non-opiate analgesics, transdermal opiate patches and muscle relaxants. While oral analgesics can effectively control post-surgical pain, they commonly cause side effects including drowsiness, constipation and cognitive impairment. Effective pain management can be compromised if patients fail to adhere to recommended dosing regimens because they are sleeping or disoriented. Post-surgical pain also can be treated effectively with local anesthetics; however, the usefulness of current conventional medications is limited by their short duration of action.

Development Strategy. We are developing POSIDUR, a sustained-release formulation of bupivacaine, using our SABER delivery system for the treatment of post-surgical pain. Bupivacaine is a local anesthetic agent currently used in the hospital for anesthesia and analgesia and for which the patent covering the chemical entity has expired. The physician would administer POSIDUR at the time of surgery to the surgical site. This formulation is designed to provide sustained regional analgesia from a single dose. We believe that by delivering effective amounts of a potent analgesic to the location from which the pain originates, adequate pain control can be achieved with minimal exposure to the remainder of the body, thus minimizing side effects. POSIDUR is intended to provide local analgesia for up to 3 days, which we believe coincides with the time period of greatest need for post-surgical pain control in most patients.

Table of Contents

POSIDUR is the subject of a collaboration agreement with Hospira, Inc. (Hospira) to develop and commercialize POSIDUR in the U.S. and Canada. POSIDUR is also the subject of a collaboration agreement with Nycomed Danmark ApS (Nycomed) to develop and commercialize POSIDUR in the European Union (E.U.) and certain other countries. Please see Third Party Collaborations for additional information.

Clinical Program. In 2007, we successfully completed a 122 patient Phase IIb clinical trial of POSIDUR for treatment of post-operative pain in patients undergoing inguinal hernia repair. In the Phase IIb trial, POSIDUR at a dose of 5 mL demonstrated statistically significant reductions in pain and in total consumption of supplemental opioid analgesic medications versus placebo. These successful results triggered an $8.0 million milestone payment by Nycomed to us under our agreement with Nycomed.

Phase IIb Inguinal Hernia Trial

Design

The POSIDUR Phase IIb clinical trial was designed to evaluate the tolerability, activity, dose response and pharmacokinetics of POSIDUR in patients undergoing open inguinal hernia repair. The trial was conducted in Australia and New Zealand as a multi-center, randomized, double blind, placebo-controlled study in 122 patients. Study patients were randomized into three treatment groups: patients that were treated with POSIDUR 2.5 mL (n=43), POSIDUR 5 mL (n=47) and placebo (n=32). The co-primary efficacy endpoints for the study were Mean Pain Intensity on Movement area under the curve (AUC), a measure of pain over a period of 1-72 hours post-surgery, and the proportion of patients requiring supplemental opioid analgesic medication during the study. Secondary efficacy endpoints included Mean Pain Intensity on Movement AUC over the period 1-48 hours post-surgery, mean total consumption of supplemental opioid analgesic medication, and time to first use of supplemental opioid analgesic medication. The threshold for statistical significance was considered to be at the $p<0.05$ level.

Results

Pain Control

In relation to the co-primary endpoint of pain reduction as measured by Mean Pain Intensity on Movement AUC 1-72 hours post-surgery, the patient group treated with POSIDUR 5 mL reported thirty-one percent (31%) less pain versus placebo (p=0.0033). A secondary endpoint measure reported a thirty-five percent (35%) reduction of pain as measured by Mean Pain Intensity on Movement AUC for the period 1-48 hours post-surgery between the POSIDUR 5 mL treatment group versus placebo (p=0.0007).

Consumption of Supplemental Opioid Analgesic Medication

Fifty-three percent (53%) of the study patients in the POSIDUR 5 mL group took supplemental opioid analgesic medications versus seventy-two percent (72%) of the placebo patients (p=0.0909). Although this positive trend for this co-primary endpoint in favor of the POSIDUR 5 mL group was not statistically significant, both secondary endpoints measuring opioid analgesic medication consumption were met at a statistically significant level. During the periods of 1-24 hours, 24-48 hours and 48-72 hours after surgery, placebo patients consumed approximately 3.5 (p=0.0009), 2.9 (p=0.0190) and 3.6 (p=0.0172) times more supplemental opioid analgesic medications (mean total daily consumption of opioid analgesic medication in morphine equivalents), respectively, than the POSIDUR 5 mL treatment group. In addition, the median time to first use of supplemental opioid analgesic medication after surgery for the placebo patients was 2.7 hours versus >72 hours for the POSIDUR 5 mL treatment group (p=0.0197).

Dose Finding

POSIDUR administered at the dose of 5 mL showed statistically significant activity relative to placebo whereas POSIDUR administered at 2.5 mL showed a positive trend relative to placebo on certain parameters but the results were not statistically significant.

Table of Contents

Safety

The patient groups treated with POSIDUR 5 mL and POSIDUR 2.5 mL showed comparable safety profiles as the patient groups treated with placebo, and the drug administration appeared well tolerated. The side effects commonly observed with opioid medication use were less frequent in the POSIDUR 5 mL and 2.5 mL treatment groups compared to placebo.

Other Phase II Clinical Trials

In addition to the Phase IIb clinical trial described above, we have also conducted smaller exploratory Phase II studies in hernia, shoulder arthroscopy and appendectomy surgeries to evaluate different application techniques, clinical design and conduct as well as other investigational factors. These trials have been conducted in multiple cohorts, generally consisting of approximately 6 to 21 patients in each treatment group. In all the exploratory studies, patient groups treated with POSIDUR 5 mL and POSIDUR 2.5 mL showed comparable safety profiles as the patient groups treated with placebo, and the drug administration appeared well tolerated. Some treatment groups from these exploratory studies utilizing POSIDUR have shown positive activity as measured by reduction of pain or consumption of supplemental opioid analgesic medication versus placebo, while other treatment groups have not. We have evaluated these studies to understand the different results observed, and have applied our learnings in the design of our Phase III program.

In December 2009, we announced results from a 60 patient Phase IIb clinical trial of POSIDUR in patients undergoing arthroscopic shoulder surgery. Top line results showed a consistent reduction of pain scores (as measured by mean pain intensity on movement AUC, time normalized under the curve, during the period 0 to 72 hours post-surgery) in parallel with a reduction of opioid use (as measured by the amount of opioids taken in the three days post-surgery) in favor of POSIDUR versus placebo. These reductions were not statistically significant given the size of the study. In addition, there was a comparable safety profile between the two groups in this study and POSIDUR appeared well tolerated.

In June 2010, we announced results from a European Phase IIb hysterectomy clinical trial conducted by Nycomed of POSIDUR. This hysterectomy trial is part of Nycomed s clinical development program for Europe for POSIDUR. In this study, 115 patients were randomly assigned to one of three treatment groups prior to undergoing open hysterectomy surgery: POSIDUR at a dose of 5 mL, an active comparator (commercially available bupivacaine HCI solution) or SABER-Placebo (SABER vehicle without drug). All patients were given a background pain treatment consisting of a daily dose of two or four grams (depending on the patient s weight) of paracetamol (acetaminophen). In addition, each patient was provided supplemental opioid rescue medication, if needed. With respect to efficacy, the primary endpoints of the study were to demonstrate: (1) non-inferiority of POSIDUR to SABER-Placebo (with all groups taking the background and supplemental pain treatment as described above) in terms of pain intensity on movement area under the curve (AUC) during the period 1-72 hours post-surgery, and (2) superiority of POSIDUR against SABER-Placebo in the total use of opioid rescue analgesia 0-72 hours post-surgery. Results from this study show that the first primary efficacy endpoint was met. With respect to the second primary efficacy endpoint, no statistically significant difference was shown in opioid use between the POSIDUR and SABER-Placebo groups. Secondary comparisons were performed towards the active comparator group with similar results. In this study, patients in all treatment groups only took a meaningful amount of opioids during a shorter period of time after surgery than was expected. In this study, there were no indications of systemic safety issues. The plasma concentration profiles were consistent with previous studies, confirming the sustained release profile of the product. Local observations (most commonly coded as post procedural haematomas) at the surgical site were observed with frequency in the POSIDUR and SABER-Placebo groups and not observed in the active comparator group. These events were temporary and resolved without treatment.

In February 2011, we announced results from a European Phase IIb shoulder clinical trial conducted by Nycomed of POSIDUR. This shoulder trial is part of Nycomed s clinical development program for Europe for POSIDUR. In this study, 107 patients were randomly assigned to one of three treatment groups prior to

Table of Contents

undergoing elective arthroscopic shoulder surgery: POSIDUR at a dose of 5 mL, an active comparator (commercially available bupivacaine HCI solution) or SABER-Placebo (SABER vehicle without drug). All patients were given a background pain treatment consisting of a daily dose of two or four grams (depending on the patient s weight) of paracetamol (acetaminophen). In addition, each patient was provided supplemental opioid rescue medication, if needed. With respect to efficacy, the primary endpoints of the study were to demonstrate: (1) non-inferiority of POSIDUR to SABER-Placebo (with all groups taking the background and supplemental pain treatment as described above) in terms of pain intensity on movement area under the curve (AUC) during the period 1 72 hours post-surgery, and (2) superiority of POSIDUR against SABER-Placebo in the total use of opioid rescue analgesia 0 72 hours post-surgery. Top-line results from this study demonstrate that the POSIDUR group experienced a statistically significant reduction in pain intensity versus SABER-Placebo. The results of the pre-specified primary analysis indicated a clear clinically relevant trend in opioid sparing for POSIDUR compared to SABER-placebo and the pre-specified sensitivity analysis showed a statistically significant difference in opioid sparing in favor of POSIDUR. No statistical differences were found when POSIDUR was compared to the active comparator arm. Overall there was a comparable safety profile between the three groups in this study and POSIDUR appeared well tolerated.

U.S. Phase III Program

In January 2010, we announced that we had commenced BESST (Bupivacaine Effectiveness and Safety in SABER Trial), which is intended to be the pivotal Phase III clinical trial in the U.S. BESST is an international, multi-center, randomized, double-blind, controlled trial evaluating the safety, efficacy, effectiveness, and pharmacokinetics of POSIDUR in approximately 300 patients undergoing a variety of general abdominal surgical procedures. Eligible patients will be randomly assigned to one of three cohorts:

Cohort 1: An active comparator cohort in which patients are randomized to receive either POSIDUR 5.0 mL or commercially available Bupivacaine HCl solution after laparotomy.

Cohort 2: An active comparator cohort in which patients are randomized to receive either POSIDUR 5.0 mL or commercially available Bupivacaine HCl solution after laparoscopic cholecystectomy.

Cohort 3: A double blind, placebo controlled cohort in which patients are randomized to receive either POSIDUR 5.0 mL or SABER-Placebo after laparoscopically-assisted colectomy.

Efficacy evaluation in the BESST trial will encompass a number of parameters. The two co-primary efficacy endpoints for Cohort 3 will be mean pain intensity on movement (normalized) Area Under the Curve (AUC) during the period 0-72 hours post-dose and mean total morphine equivalent opioid dose for supplemental analgesia during the period 0-72 hours post-dose. An adaptive feature of BESST allows for increasing the patient sample size in Cohort 3 based on pooled and blinded data. The purpose of Cohorts 1 and 2 is to give us additional experience with the use of POSIDUR in a broader group of surgeries and patients.

In April 2010, we had a FDA interaction which increased our confidence that the BESST design and overall NDA strategy, subject to data review from the entire POSIDUR development program, addresses the FDA s comments provided during past interactions regarding safety and evaluation of a diverse patient population that is likely to be exposed to the marketed product.

ELADUR

Market Opportunity. Pain can arise from a variety of diseases and conditions, and in many instances, pain originates from a localized point in the body and can benefit from treatments which are administered and act locally as opposed to in a systemic fashion. One such example is post-herpetic neuralgia (PHN or post-shingles pain), a debilitating complication of herpes zoster, which is usually defined as the presence of pain at the site of eruption that lasts more than a month after the onset of a zoster eruption. The prevalence of PHN (including PHN lasting more than one year) is estimated to be approximately 144,000 people in the U.S. In addition to PHN, there are a number of other widely prevalent chronic and acute local pain conditions (e.g., neuropathic pain, back pain, sprains, strains, and contusions) that could benefit from a locally acting pain product.

Table of Contents

Development Strategy. We are developing a transdermal bupivacaine patch (ELADUR) based on our proprietary TRANSDUR transdermal technology intended to provide continuous delivery of bupivacaine for up to three days from a single application, as compared to a wearing time limited to 12 hours with currently available lidocaine patches. We anticipate that ELADUR will have several potential differentiating attributes compared with currently marketed lidocaine patches, including extended duration of action and better wearability. During 2008, we received Orphan Drug Designation for bupivacaine for relief of persistent pain associated with PHN, such that if ELADUR is the first bupivacaine product approved for PHN, ELADUR would be eligible to receive seven years of data exclusivity following its approval by the FDA. There can be no assurance that ELADUR will be the first bupivacaine product approved for PHN, and therefore ELADUR may not be entitled to the seven year data exclusivity period for orphan drugs. Effective October 2008, we licensed the worldwide development and commercialization rights for ELADUR to Alpharma Ireland Limited (Alpharma), which was acquired by King in December 2008. In February 2011, Pfizer acquired King and thereby assumed the rights and obligations of King with respect to ELADUR.

Clinical Program. In 2007, we reported positive results from a 60 patient Phase IIa clinical trial for ELADUR. In this study of patients suffering from PHN, ELADUR showed improved pain control versus placebo during the 3-day continuous treatment period. In addition, ELADUR appeared well tolerated overall, and patients treated with ELADUR and placebo exhibited similar safety profiles. In 2008, we conducted manufacturing scale-up and processing studies to secure additional supplies for Phase II and Phase III clinical trials, and developed our clinical and regulatory strategy for further development of this program. In April 2010, King initiated a 260 patient Phase IIb study evaluating the safety and efficacy of ELADUR in patients with chronic low back pain; we expect to receive top-line results from this study in the first half of 2011.

TRANSDUR-Sufentanil Patch

Market Opportunity. Chronic pain affects as many as 50 million Americans annually. One major class of drugs utilized to treat chronic pain is comprised of oral opioids, such as OxyContin, a branded extended-release oral oxycodone-based painkiller which accounted for over $3.0 billion in worldwide sales in 2010. Another major class of drugs utilized to treat chronic pain is transdermally delivered opioids such as Duragesic®, a leading transdermal fentanyl product which accounted for approximately $750 million in worldwide sales in 2010. It is our belief that a best-in-class sufentanil patch could compete effectively in both the transdermal fentanyl patch market and in the oral opioid market.

Development Strategy. Our transdermal sufentanil patch (TRANSDUR-Sufentanil) under development is based on our proprietary TRANSDUR transdermal technology and is intended to provide continuous delivery of sufentanil for up to seven days from a single application, as compared to the two to three days of relief provided by currently available fentanyl patches. Sufentanil is a highly potent opioid that is currently used in hospitals as an analgesic for which the patent covering the chemical entity has expired. We anticipate that the small size of our sufentanil patch (potentially as small as 1/5th the size of currently marketed transdermal fentanyl patches for a therapeutically equivalent dose) and longer duration of delivery may offer improved convenience and compliance for patients.

In March 2005, we entered into an agreement with Endo Pharmaceuticals, Inc. (Endo) granting Endo exclusive rights to develop, market and commercialize TRANSDUR-Sufentanil in the U.S. and Canada. We received an initial payment of $10.0 million in connection with the execution of the agreement. In February 2009, Endo notified us that it was terminating the license agreement with us, and thereby returning Endo s rights to develop and commercialize TRANSDUR-Sufentanil in the U.S. and Canada to us effective August 26, 2009. We are in discussions with potential collaborators regarding licensing development and commercialization rights to this program to which we hold worldwide rights.

Clinical Program. In 2008, Endo successfully completed a Phase II clinical trial for TRANSDUR- Sufentanil in which they evaluated the conversion of patients on oral and transdermal opioids to TRANSDUR-Sufentanil. This Phase II trial met its primary and secondary objectives of establishing a successful dose-titration

Table of Contents

regimen and dose potency relationships, demonstrating safety and tolerability at the therapeutic dose, and achieving effective analgesic pain control. The Phase II data, extensive non-clinical data that had been generated by Endo and a potential regulatory pathway for the Phase III program were reviewed with the FDA at an end-of-Phase II meeting on February 19, 2009. It is our expectation that future development of this product candidate will follow a 505(b)2 pathway as discussed with FDA, which would allow us to reference third-party data, potentially reducing time and expense.

ORADUR-ADHD Program

Market Opportunity. Attention Deficit Hyperactivity Disorder (ADHD) is a neurobehavioral condition that is estimated to affect approximately 8% of U.S. children ages 4-17, according to the U.S. Centers for Disease Control and Prevention (the CDC). The principal characteristics of ADHD are inattention, hyperactivity, and impulsivity. The condition presents itself in childhood and can be life long as 65% of children with ADHD continue to present symptoms as adults. Over 50% of children with ADHD are currently treated with stimulants such as amphetamine or methylphenidate and sales of ADHD treatments were approximately $4.7 billion in 2009. The National Survey on Drug Use & Health estimates that 1.4 million Americans over the age of 12 abuse stimulants for euphoric highs and increased performance or wakefulness.

Development Strategy. We are developing a drug candidate (ORADUR-ADHD) based on DURECT s ORADUR Technology for the treatment of ADHD. This drug candidate is intended to provide once-a-day dosing with added tamper resistant characteristics to address common methods of abuse and misuse of these types of drugs. In August 2009, we entered into a development and license agreement with Orient Pharma Co., Ltd., a diversified multinational pharmaceutical, healthcare and consumer products company with headquarters in Taiwan, under which we granted to Orient Pharma development and commercialization rights in certain defined Asian and South Pacific countries to ORADUR-ADHD. DURECT retains rights to North America, Europe, Japan and all other countries not specifically licensed to Orient Pharma. Under our agreement with Orient Pharma, the parties will collaborate to perform a clinical development program through a Phase II study intended to produce a data package suitable for further development of the drug candidate by us as well as Orient Pharma in their respective territories. We will be responsible for formulation and study design of the Phase I and Phase II clinical program which Orient Pharma has agreed to fund and execute. Orient Pharma would be responsible for all remaining development and commercialization activities for ORADUR-ADHD in the licensed territory. If commercialized, we will be entitled to receive a royalty on sales of ORADUR-ADHD by Orient Pharma. Orient Pharma has committed to supply a portion of DURECT s commercial requirements for ORADUR-ADHD in all territories other than the U.S. In July 2010, we commenced a Phase I clinical trial in this program with multiple formulations.

Biologics Programs

The proteins and genes identified by the biotechnology industry are large, complex, intricate molecules, and many are unsuitable as drugs. If these molecules are given orally, they are often digested before they can have an effect; if given by injection, they may be destroyed by the body s natural processes before they can reach their intended sites of action. The body s natural elimination processes require frequent, high dose injections that may result in unwanted side effects. As a result, the development of biotechnology molecules for the treatment of human diseases has been limited, and advanced drug delivery systems such as we possess are required to realize the full potential of many of these protein and peptide drugs. We have active programs underway to apply our drug delivery systems to various biotechnology drugs and drug candidates, and have entered into a number of feasibility studies with biotechnology and pharmaceutical companies to test their products in our systems.

Research Programs in other Therapeutic Categories

We have underway a number of research programs covering medical diseases and conditions other than pain. Such programs include various diseases and disorders including schizophrenia and cancer. In conducting our research programs and determining which particular efforts to prioritize for formal development, we employ

Table of Contents

a rigorous opportunity assessment process that takes into account the unmet medical need, commercial opportunity, technical feasibility, clinical viability, intellectual property considerations, and the development path including costs to achieve various critical milestones.

Industry Background

Chronic Diseases and Conditions

Although the pharmaceutical, biotechnology and medical device industries have played key roles in increasing life expectancy and improving health, many chronic, debilitating diseases continue to be inadequately addressed with current drugs or medical devices. Cardiovascular disease, cancer, neurodegenerative diseases, diabetes, arthritis, epilepsy and other chronic diseases claim the lives of millions of Americans each year. These illnesses are prolonged, are rarely cured completely, and pose a significant societal burden in mortality, morbidity and cost. The CDC estimates that the major chronic diseases are responsible for approximately 1.7 million deaths annually, or 70% of all deaths in the U.S. Chronic diseases cause major limitations in daily living for more than 25 million Americans. These diseases account for more than 70% of the cost of health care each year in the U.S. Demographic trends suggest that, as the U.S. population ages, the cost of treating chronic diseases will increase.

Current Approaches to Treatment

Drugs are available to treat many chronic diseases, but harmful side effects can limit prolonged treatment. In addition, patients with chronic diseases commonly take multiple medications, often several times a day, for the remainder of their lives. If patients fail to take drugs as prescribed, they often do not receive the intended benefits or may experience side effects, which are harmful or decrease quality of life. These problems become more common as the number of drugs being taken increases, the regimen of dosing becomes more complicated, or the patient ages or becomes cognitively impaired. It is estimated that only half of prescribed medicines are taken correctly.

The Pharmaceutical Industry. The pharmaceutical industry has traditionally focused on the chemical structure of small molecules to create drugs that can treat diseases and medical conditions. The ability to use these molecules as drugs is based on their potency, safety and efficacy. Therapeutic outcome and ultimately the suitability of a molecule as a drug depends to a large extent on how it gets into the body, distributes throughout the body, reacts with its intended site of action and is eliminated from the body. However, small molecules can act in diverse tissues throughout the body resulting in unwanted side effects.

Most drugs require a minimum level in blood and tissues to have significant therapeutic effects. Above a maximum level, however, the drug becomes toxic or has some unwanted side effects. These two levels define the therapeutic range of the drug. With conventional oral dosing and injections, typically a large quantity of drug is administered to the patient at one time, which results in high blood levels of drug immediately after dosing. Because of these high levels, the patient can be over-medicated during the period immediately following dosing, resulting in wasted drug and possible side effects. Due to distribution processes and drug clearance, the blood level of drug falls as time elapses from the last dose. For some duration, the patient is within the desired therapeutic range of blood levels. Eventually, the blood level of drug falls sufficiently such that the patient becomes under-medicated and experiences little or no drug effect until the next dose is administered.

The Biotechnology Industry. Over the past twenty-five years, the biotechnology revolution and the expanding field of genomics have led to the discovery of huge numbers of proteins and genes. Tremendous resources have been committed in the hope of developing drug therapies that would better mimic the body s own processes and allow for greater therapeutic specificity than is possible with small molecule drugs. Unfortunately, this huge effort has led to only a limited number of therapeutic products. The proteins and genes identified by the biotechnology industry are large, complex, intricate molecules, and many are unsuitable as drugs. If these molecules are given orally, they are often digested before they can have an effect; if given by injection, they may

Table of Contents

be destroyed by the body s natural processes before they can reach their intended sites of action. The body s natural elimination processes require frequent, high dose injections that may result in unwanted side effects. As a result, the development of biotechnology molecules for the treatment of human diseases has been limited.

The Drug Delivery Industry. In the last forty years, a multibillion dollar drug delivery industry has developed on the basis that medicine can be improved by delivering drugs to patients in a precise, controlled fashion. Several commercially successful oral controlled release products, transdermal controlled release patches, and injectable controlled release formulations have been developed. These products demonstrate that the delivery system can be as important to the ultimate therapeutic value of a pharmaceutical product as the active molecule or compound itself. However, drug delivery products on the market today can still be improved, for example, by providing reduced abuse potential, targeted delivery to minimize systemic effects and longer delivery durations where useful. Furthermore, traditional drug delivery products are generally not capable of administering biotechnology agents such as proteins and peptides.

The DURECT Solution: Pharmaceutical Systems

We are developing and commercializing pharmaceutical systems that will deliver the right drug to the right place, in the right amount and at the right time to treat chronic and episodic diseases and conditions. Our pharmaceutical systems enable optimized therapy for a given disease or patient population by controlling the rate and duration of drug administration. In addition, if advantageous for the therapy, our pharmaceutical systems can target the delivery of the drug to its intended site of action.

The Right Drug: By precisely controlling the dosage or targeting delivery to a specific site, we can expand the therapeutic use of compounds that would otherwise be too potent to be administered systemically, do not remain in the body long enough to be effective, or have significant side effects when administered systemically. This flexibility allows us to work with a variety of drug candidates including small molecules, proteins, peptides or genes.

The Right Place: In addition to enabling systemic delivery, if advantageous for the therapy, with precise placement of our proprietary catheters or biodegradable drug delivery formulations, we can design our pharmaceutical systems to deliver drugs directly to the intended site of action. This can ensure that the drug reaches the target tissue in effective concentrations, eliminate many side effects caused by delivery of the drug to unintended sites in the body, and reduce the total amount of drug administered to the body.

The Right Amount: Our pharmaceutical systems can automatically deliver drug dosages continuously within the desired therapeutic range for the duration of the treatment period, from days to up to months, without the fluctuations in drug levels typically associated with conventional pills or injections. This can reduce side effects, eliminate gaps in drug therapy, conveniently ensure accurate dosing and patient compliance, and may reduce the total amount of drug administered to the body.

The Right Time: Our pharmaceutical systems technologies are designed to minimize the need for intervention by the patient or care-giver and to enhance dosing compliance. In addition to reducing the cost of care, continuous drug therapy frees the patient from repeated treatment or hospitalization, improving convenience and quality of life. Our systems are well-suited to deliver drug for the right period of time for the intended indication, whether for hours or days for acute indications or months or years for treating chronic, debilitating diseases such as chronic pain, cancer, heart disease, and neurodegenerative diseases. We believe that it is more effective to treat chronic diseases with continuous, long-term therapy than with alternatives such as multiple conventional injections or oral dosage forms that create short-term effects.

Table of Contents

DURECT Pharmaceutical Systems Technology

Our pharmaceutical systems combine engineering with proprietary small molecule pharmaceutical and biotechnology drug formulations to yield proprietary delivery technologies and products. Through this combination, we are able to control the rate and duration of drug administration, as well as, when desired, target the delivery of the drug to its intended site of action, allowing our pharmaceutical systems to meet the special challenges associated with treating medical conditions over an extended period of time. Our pharmaceutical systems can enable new drug therapies or optimize existing therapies based on a broad range of compounds, including small molecule pharmaceuticals as well as biologics such as proteins, peptides and genes.

Our pharmaceutical systems are suitable for providing long-term drug therapy because they store highly concentrated, stabilized drugs in a small volume and can protect the drug from degradation by the body. This, in combination with our ability to continuously deliver precise and accurate doses of a drug, allows us to extend the therapeutic value of a wide variety of drugs, including those which would otherwise be ineffective, too unstable, too potent or cause adverse side effects. In some cases, delivering the drug directly to the intended site of action can improve efficacy while minimizing unwanted side effects elsewhere in the body, which often limit the long-term use of many drugs. Our pharmaceutical systems can thus provide better therapy for chronic diseases or conditions, or for certain acute conditions where longer drug dosing is required or advantageous, by replacing multiple injection therapy or oral dosing, improving drug efficacy, reducing side effects and ensuring dosing compliance. Our pharmaceutical systems can improve patients quality of life by eliminating more repetitive treatments, reducing dependence on caregivers and allowing patients to lead more independent lives.

We currently have six major technology platforms:

The SABER Delivery System

The SABER system is a patented controlled-release technology that can be formulated for systemic or local administration of active agents via the parenteral or oral route. We are researching and developing a variety of controlled-release products based on the SABER technology. These include injectable controlled release products for systemic and local delivery and oral products. We believe that our SABER system can provide the basis for the development of a state-of-the-art biodegradable, controlled-release injectable. The SABER system uses a high-viscosity base component, such as sucrose acetate isobutyrate (SAIB), to provide controlled release of a drug. When the high viscosity SAIB is formulated with drug, biocompatible excipients and other additives, the resulting formulation is liquid enough to inject easily with standard syringes and needles. After injection of a SABER formulation, the excipients diffuse away, leaving a viscous depot. Depending on how it is formulated, the SABER system can successfully deliver therapeutic levels of a wide spectrum of drugs from one day to three months from a single injection. Based on research and development work to date, our SABER technology has shown the following advantages:

Peptide/Protein Delivery The chemical nature of the SABER system tends to repel water and body enzymes from its interior and thereby stabilizes proteins and peptides. For this reason, we believe that the SABER system is well suited as a platform for biotechnology therapeutics based on proteins and peptides.

Less Burst Typically, controlled release injections are associated with an initial higher release of drug immediately after injection (also called burst). Animal and human studies have shown that injectables based on the SABER technology can be associated with less post-injection burst than is typically associated with other commercially available injectable controlled release technologies.

High Drug Concentration Drug concentration in a SABER formulation can be as high as 30%, considerably greater than is typical with other commercially available injectable controlled release technologies. As a result, smaller injection volumes are possible with this technology.

Ease of Administration Prior to injection, SABER formulations are fairly liquid and therefore can be injected through small needles. Additionally, because of the higher drug concentration of SABER

11

Table of Contents

formulations, less volume is required to be injected. Small injection volumes and more liquid solutions are expected to result in easier, less painful administration.

Strong Patent Protection The SABER system, SABER-like materials, and various applications of this technology to pharmaceuticals, medical devices and drug delivery are covered by United States and foreign patents. See Patents, Licenses and Proprietary Rights below.

Ease of Manufacture Compared to microspheres and other polymer-based controlled release injectable systems, SABER is readily manufacturable at low cost.

The SABER Technology is the basis of POSIDUR, which is in a Phase III clinical trial in the U.S. and in Phase II in the E.U. In our clinical studies thus far, SABER formulations have been observed to be safe and well-tolerated, and no significant side effects or adverse events were reported.

The SABER Technology is also the basis for SucroMate Equine, an injectable animal health drug utilizing DURECT s SABER technology to deliver the peptide deslorelin. This is the first FDA approved SABER injectable product and it was recently launched by our collaborator, CreoSalus, Inc.

The TRANSDUR Transdermal Delivery System

Our TRANSDUR technology is a proprietary transdermal delivery system that enables delivery of drugs continuously for up to 7 days. The TRANSDUR technology is the basis for TRANSDUR-Sufentanil for which an end-of-Phase II meeting with the FDA was held in February 2009 and for which we hold worldwide development and commercialization rights. The TRANSDUR technology is also the basis for ELADUR, which is currently in Phase II testing and which we have licensed worldwide development and commercialization rights to Alpharma (which was acquired by King in December 2008, which in turn was subsequently acquired by Pfizer in February 2011).

The ORADUR Sustained Release Gel Cap Technology

We are developing ORADUR sustained release oral technology based on our SABER technology. We believe that ORADUR can transform short-acting oral capsule dosage forms into sustained release oral products. Products based on our ORADUR technology can take the form of an easy to swallow gelatin capsule that uses a high-viscosity base component such as sucrose acetate isobutyrate (SAIB) to provide controlled release of active ingredients for a period of 12 to 24 hours of drug delivery. Oral dosage forms based on the ORADUR gel-cap may also have the added benefit of being less prone to abuse (e.g., by crushing or alcohol or water extraction) than other controlled release dosage forms on the market today. These properties have the potential to make ORADUR-based products an attractive option for pharmaceutical companies that seek to develop abuse deterrent oral products. The ORADUR technology is the basis of Remoxy, a novel long-acting oral formulation of the opioid oxycodone which is targeted to decrease the potential for oxycodone abuse. In December 2007, Remoxy successfully completed a pivotal Phase III clinical trial. Pain Therapeutics submitted an NDA for Remoxy to the FDA in June 2008, and in August 2008, the NDA was accepted by the FDA and granted priority review. In December 2008, Pain Therapeutics received a Complete Response Letter for its NDA for Remoxy in which the FDA determined that the NDA was not approved. According to Pain Therapeutics, the FDA indicated that additional non-clinical data would be required to support the approval of Remoxy but the FDA had not requested or recommended additional clinical efficacy studies prior to approval. King Pharmaceuticals assumed responsibility for further development of Remoxy from Pain Therapeutics in March 2009. On July 2, 2009, King met with the FDA to discuss the Complete Response Letter. According to King and Pain Therapeutics, the outcome of that meeting provided King with a clearer path forward to resubmit the Remoxy NDA and to address all FDA comments in the Complete Response Letter. King resubmitted the NDA in December 2010; this was a Class II resubmission and the FDA has indicated that it has set a June 23, 2011 PDUFA goal date for Remoxy.

During 2006, 2007, 2008 and 2010, we also worked with Pain Therapeutics and King on the development of three additional ORADUR abuse-resistant opioid drug candidates which would address the chronic pain market.

Table of Contents

Phase I clinical trials have been conducted for two of these ORADUR-based products (hydrocodone and hydromorphone), and an IND has been accepted by the FDA for the third ORADUR-based opioid (oxymorphone).

We also have an ORADUR-ADHD program for which we commenced a Phase I clinical trial with multiple formulations in July 2010.

The DURIN Biodegradable Implant Technology

Our DURIN technology is a proprietary biodegradable implant that enables parenteral delivery of drugs from several weeks to six months or more using our LACTEL brand polymers and co-polymers of lactic and glycolic acid. The DURIN technology can deliver a wide variety of drugs including small and large molecule compounds. Our proprietary implant design allows for a variety of possible delivery profiles including constant rate delivery. Because DURIN implants are biodegradable, at the end of its delivery life, what remains of the DURIN implant is absorbed by the body. The DURIN technology is the basis of Memryte for the treatment of Alzheimer s disease, with any future development controlled by Curaxis.

The DUROS Technology

The DUROS system is a miniature drug-dispensing pump which can be as small as a wooden matchstick. We have licensed the DUROS system for specified fields of use from ALZA Corporation (ALZA), pursuant to a development and commercialization agreement entered into effective April 1998. The DUROS system can be used for therapies requiring systemic or site-specific administration of drug. To deliver drugs systemically, the DUROS system is placed just under the skin, for example in the inner side of the upper arm, in an outpatient procedure that is completed in just a few minutes using local anesthetic. Removal or replacement of the product is also a simple and quick procedure completed in the doctor s office.

The MICRODUR Biodegradable Microparticulate Technology

Our MICRODUR technology is a patented biodegradable microparticulate depot injectable. We have experience in microencapsulation of a broad spectrum of drugs using our LACTEL brand polymers and co-polymers of lactic and glycolic acid. In our MICRODUR process, both standard and proprietary polymers are used to entrap an active agent in solid matrices or capsules comprising particles generally between 10 and 125 microns in diameter. Through a suitable choice of polymers and processing, sustained release from a few days to many months can be achieved. As with the DURIN technology, MICRODUR particles degrade fully in the body after the active agent is released. Our range of experience extends from the manufacturing of the polymer raw material to process and product development, scale-up and cGMP manufacturing.

DURECT Strategy

Our objective is to become a specialty pharmaceutical company by developing, and in the future, commercializing pharmaceutical systems that address significant medical needs and improve patients quality of life. To achieve this objective, our strategy includes the following key elements:

Focus on Chronic Debilitating Medical Conditions and Certain Local Pain Conditions. Many of the diseases that present the greatest challenges to medicine are chronic, debilitating diseases such as chronic pain, CNS disorders, cardiovascular disorders, cancer and degenerative neurological diseases. In addition, we have identified certain local and acute pain conditions that we believe can be addressed by improved therapeutics. Our initial efforts will focus on using our versatile drug delivery platform technologies to develop products that address these medical conditions.

Minimize Product Development Risk and Speed Time-to-Market. Initially, we intend to minimize product development risk and speed time-to-market by using our drug delivery platform technologies to administer drugs

Table of Contents

for which medical data on efficacy and safety are available. This strategy reduces much of the development risk that is inherent in traditional pharmaceutical product discovery. We anticipate that we can expand the medical usefulness of existing well-characterized drugs in several ways:

- expand uses or create new uses for existing drugs by delivering drugs continuously for convenient long dosing intervals;
- create new uses for drugs which were previously considered to be too potent to be used safely by precisely controlling dosing;
- deliver drugs by injection or transdermally to eliminate the first pass effect whereby the efficacy of the active agent is impacted by digestion and deactivation;
- enhance drug performance by minimizing side effects; and
- expand uses of drugs by delivering them to the target site.

We anticipate that our pharmaceutical systems can be more rapidly developed at lower cost than comparable products that are developed purely based on chemical solutions to the problems of efficacy, side effects, stability and delivery of the active agent. We believe that our ability to innovate more rapidly will allow us to respond more quickly to market feedback to optimize our existing pharmaceutical systems or develop line extensions that address new market needs.

Enable the Development of Pharmaceutical Systems Based on Biotechnology and Other New Compounds. We believe there is a significant opportunity for pharmaceutical systems to add value to therapeutic medicine by administering biologics, such as proteins, peptides and genes. We believe our technologies will improve the specificity, potency, convenience and cost-effectiveness of proteins, peptides, genes and other newly discovered drugs. Our systems can enable these compounds to be effectively administered, thus allowing them to become viable medicines. We can address the stability and storage needs of these compounds through our advanced formulation technology and package them in a suitable pharmaceutical system for optimum delivery. Through continuous administration, the SABER, DURIN, DUROS and MICRODUR technology platforms may eliminate or reduce the need for multiple injections of these drugs. In addition, through precise placement of our proprietary biodegradable drug formulations, proteins and genes can be delivered to specific tissues for extended periods of time, thus ensuring that large molecule agents are present at the desired site of action and minimizing the potential for adverse side effects elsewhere in the body.

Diversify Risk by Pursuing Multiple Programs in Development. In order to reduce the risks inherent in pharmaceutical product development, we have diversified our product pipeline such that, between our own programs and those where we have collaborated, we presently have one program for which response to a Complete Response Letter has been submitted and a PDUFA goal date of June 23, 2011 is established, and six different disclosed programs in clinical development, including three oral drug candidates, two transdermal patch candidates and one injectable drug candidate. We believe that having multiple programs in development helps mitigate the negative consequences to us of any setbacks or delays in any one of our programs.

Enable Product Development Through Strategic Collaborations. We believe that entering into selective collaborations with respect to our product development programs can enhance the success of our product development and commercialization, mitigate our risk and enable us to better manage our operating costs. Additionally, such collaborations enable us to leverage investment by our collaborators and reduce our net cash burn, while retaining significant economic rights.

Build Our Own Commercial Organization. In the future, we may elect to build our own commercial, sales and marketing capability in order to capture more of the economic value of certain products that we may develop. If we choose to enter into third-party collaborations to commercialize our pharmaceutical systems, we may in the future enter into these alliances under circumstances that allow us to participate in the sales and marketing of these products.

Table of Contents

Third-Party Collaborations

We have entered into the following agreements in connection with our third party collaborations:

Hospira, Inc. In June 2010, we entered into a license agreement with Hospira to develop and commercialize POSIDUR in the U.S. and Canada. Under terms of the agreement, Hospira made an upfront payment of $27.5 million, with the potential for up to an additional $185 million in performance milestone payments based on the successful development, approval and commercialization of POSIDUR in the U.S. and Canada. For the U.S. and Canada, the two companies will jointly direct and equally fund the remaining development costs for POSIDUR, while Hospira will have exclusive commercialization rights upon regulatory approval with sole funding responsibility for commercialization activities. In addition, the Company has also granted to Hospira the right to develop and commercialize in the U.S. and Canada, at Hospira s sole cost, other specified local anesthetic products, if any, based on the SABER technology, which come into existence under the Agreement. Hospira will be responsible for commercial manufacture of licensed products under the Agreement, provided that the Company will supply to Hospira a specified excipient for use in the manufacture of licensed products pursuant to a supply agreement entered into by the parties. On a product by product basis, Hospira will pay us a royalty on sales of each licensed product commercialized under the Agreement for a defined period, after which the license granted to Hospira for such product shall convert to a fully paid-up, non-royalty bearing and perpetual license. The term of the agreement shall be for the duration of Hospira s obligation to pay royalties for product sales under the Agreement. The agreement provides each party with specified termination rights, including the right of Hospira to terminate at will after a specified period and each party to terminate the agreement upon material breach of the agreement by the other party. The agreement also contains terms and conditions customary for this type of arrangement, including representations, warranties and indemnities. As of December 31, 2010, the cumulative aggregate payments received by us under this agreement were $29.7 million.

Alpharma Ireland Limited (acquired in December 2008 by King which subsequently was acquired by Pfizer in February 2011). In September 2008, we and Alpharma entered into a development and license agreement granting Alpharma the exclusive worldwide rights to develop and commercialize ELADUR, our investigational transdermal bupivacaine patch. The agreement became effective in October 2008. Under the terms of the agreement, upon closing of the transaction, Alpharma paid us an upfront license fee of $20 million, with possible additional payments of up to $93 million upon the achievement of predefined development and regulatory milestones spread over multiple clinical indications and geographical territories as well as possible additional payments of up to $150 million in sales-based milestones. If ELADUR is commercialized, we would also receive royalties on product sales. Alpharma will control and fund further development of the program. The term of the agreement will continue on a jurisdiction-by-jurisdiction basis until the later of fifteen (15) years from the date of first commercial sale of ELADUR or the expiration of patent coverage or data exclusivity in each such jurisdiction. During the term of the agreement, subject to specified conditions, neither party nor their affiliates may develop or commercialize a transdermal patch containing bupivacaine. Upon expiration of the term of the agreement, the rights and licenses granted to Alpharma will convert to fully paid-up, non-royalty bearing, perpetual rights and licenses. The agreement provides each party with specified termination rights, including the right of Alpharma to terminate at any time without cause and each party to terminate the agreement upon material breach of the agreement by the other party. The agreement also contains terms and conditions customary for this type of arrangement, including representations, warranties and indemnities. As a result of the acquisition of Alpharma by King in December 2008, King assumed Alpharma s rights and obligations under the agreement. In February 2011, Pfizer acquired King and thereby assumed the rights and obligations of King with respect to ELADUR. As of December 31, 2010, the cumulative aggregate payments received by us under this agreement were $27.6 million.

Nycomed Danmark ApS. In November 2006, we entered into a collaboration agreement with Nycomed, and this agreement was amended in February 2010 and February 2011. Under the terms of the 2010 amended agreement, we licensed to Nycomed the exclusive commercialization rights to POSIDUR for the European Union (E.U.) and certain other countries. Nycomed paid us an upfront license fee of $14.0 million in 2006 and an $8.0 million milestone payment in 2007 triggered by achievement of a clinical development milestone, with future

Table of Contents

potential additional milestone payments of up to $181.0 million upon achievement of defined development, regulatory and sales milestones. Prior to the February 2010 amendment, the agreement provided for us and Nycomed to jointly direct and equally fund a development program for POSIDUR intended to secure regulatory approval in both the U.S. and the E.U. After the amendment, we now have final decision-making authority over clinical trials intended for the U.S. registration of POSIDUR. Subject to our right to initiate dispute resolution procedures in specified circumstances, Nycomed now has final decision-making authority over clinical trials for the E. U. and other countries licensed to it. We now have funding responsibility for all current and future clinical trials intended for U.S. registration of POSIDUR and, commencing April 1, 2010, Nycomed has sole funding responsibility for all clinical trials intended for E.U. registration of POSIDUR. The final decision making authority and financial responsibility for the remainder of the development activities, such as the non-clinical and CMC activities, will be jointly managed and funded by us and Nycomed. In February 2011, the agreement was further amended such that during the period commencing from January 1, 2011 until a specified period after the results are delivered from DURECT to Nycomed from DURECT s U.S. Phase III clinical trial for POSIDUR referred to as BESST (Bupivacaine Effectiveness and Safety in SABER Trial) (such period the Interim Period), DURECT shall assume full funding responsibility and final decision making authority for these activities. Furthermore, during this Interim Period, Nycomed s development and commercialization responsibility relating to POSIDUR for the territory licensed to Nycomed shall be confined to bringing its E.U. Phase IIb Clinical Trial in shoulder surgery to a full completion. Unless the Agreement is otherwise terminated, at the conclusion of the Interim Period, under the 2011 amendment, Nycomed would resume joint control and shared funding responsibility with DURECT for the non-clinical and Chemistry Manufacturing and Controls (CMC) activities for POSIDUR for the U.S. and E.U. territories. Prior to the 2011 amendment, Nycomed had the right to terminate the agreement after specified periods after data was received from certain clinical trials of POSIDUR in the E.U. and the U.S., including BESST. The foregoing right was modified by the 2011 amendment to provide that Nycomed may exercise its right to terminate the agreement at its sole election if BESST data was not available by December 31, 2011. In addition, we will be responsible for manufacturing and supplying the product to Nycomed for commercial sale in the territory licensed to Nycomed. Nycomed will pay us blended royalties on sales in the defined territory of 15-40% depending on annual sales, as well as a manufacturing markup. We retain full commercial rights to POSIDUR in all other countries not specifically licensed to Nycomed. The agreement will continue in effect until terminated. The agreement provides each party with specified termination rights, including the right of each party to terminate the agreement upon material breach of the agreement by the other party. In addition, Nycomed has the right to terminate the agreement after the expiration of patents covering POSIDUR in all major market countries in the E.U., for adverse product events, and within specified periods after certain clinical trials of POSIDUR. As of December 31, 2010, the cumulative aggregate payments received by us under this agreement were $36.1 million. In addition, the cumulative aggregate payments paid by us under this agreement to Nycomed were $9.0 million as of December 31, 2010.

Pain Therapeutics, Inc. In December 2002, we entered into an exclusive agreement with Pain Therapeutics to develop and commercialize on a worldwide basis oral sustained release, abuse deterrent opioid products incorporating four specified opioid drugs using our ORADUR technology. The agreement also provides Pain Therapeutics with the exclusive right to commercialize products developed under the agreement on a worldwide basis. In connection with the execution of the agreement, Pain Therapeutics paid us an upfront fee. In November 2005, Pain Therapeutics sublicensed the worldwide commercialization rights (except for Australia and New Zealand) to certain products developed under the agreement (including Remoxy) to King. In February 2011 Pfizer acquired King and thereby assumed the rights and obligations of King with respect to the sublicense agreement. In December 2005, we amended our agreement with Pain Therapeutics in order to specify our obligations with respect to the supply of key excipients for use in the licensed products. Under the amended agreement, we are responsible for formulation development, supply of selected key excipients used in the manufacture of licensed product and other specified tasks. We receive reimbursement for our research and development efforts on the licensed products and a manufacturing profit on our supply of key product excipients to Pain Therapeutics for use in the licensed products. Under the agreement with Pain Therapeutics, subject to and upon the achievement of predetermined development and regulatory milestones for the four drug candidates currently in development, we are entitled to receive milestone payments of up to $9.3 million in the aggregate.

Table of Contents

As of December 31, 2010, we had received $1.7 million in cumulative milestone payments. In addition, if commercialized, we will receive royalties for Remoxy and other licensed products which do not contain an opioid antagonist of between 6.0% to 11.5% of net sales of the product depending on the sales volumes. This agreement can be terminated by either party for material breach by the other party and by Pain Therapeutics without cause. As of December 31, 2010, the cumulative aggregate payments received by us from Pain Therapeutics under this agreement were $32.2 million.

In March 2009, King assumed the responsibility for further development of Remoxy from Pain Therapeutics. As a result of this change, we will continue to perform Remoxy related activities in accordance with the terms and conditions set forth in the license agreement between us and Pain Therapeutics, but with King substituted in lieu of Pain Therapeutics with respect to interactions with us in our performance of those activities including the obligation to pay us with respect to all Remoxy related costs incurred by us. The cumulative aggregate payments received by us from King as of December 31, 2010 were $4.2 million under this agreement.

During 2008, we began to manufacture commercial lots of certain key excipients that are included in Remoxy to meet the anticipated requirements for these components. In addition, during the second, third and fourth quarters of 2008 and the first quarter of 2009, we made shipments of these materials to meet the production requirements of King, which has rights to commercialize Remoxy upon approval by the FDA. During these periods, all product revenue and associated cost of goods sold was deferred pending the establishment of definitive final terms and conditions even though cash receipts and expenditures occurred during these periods.

In August 2009, we entered into an exclusive long term excipient supply agreement with respect to REMOXY with King. In February 2011, Pfizer acquired King and thereby assumed the rights and obligations of King with respect to the long term excipient supply agreement. This agreement stipulates the terms and conditions under which we will supply to King, based on our manufacturing cost plus a specified percentage mark-up, two key excipients used in the manufacture of REMOXY. The term of the agreement commenced on August 5, 2009 and will continue in effect until the earlier of the expiration of all licenses granted under the development and license agreement between the us and Pain Therapeutics or the termination or expiration of the 2005 development and license agreement between Pain Therapeutics and King, unless the agreement is terminated earlier in accordance with its terms. The agreement provides each party with specified termination rights, which include, but are not limited to, the right of King to terminate the agreement in the event that governmental action requires the withdrawal of REMOXY from all countries in the territory or results in the withdrawal of required manufacturing approvals, or upon a change of control of us, in which case termination will be effective one year after notice by King. We may terminate the agreement if we are unable to procure suitable and sufficient quantities of certain raw materials required to produce the excipient ingredients. Each party may terminate the agreement upon material breach of the agreement by, or the bankruptcy or insolvency of, the other party, in each case subject to a cure period. The agreement further specifies the rights and obligations of us and King with respect to plant allocation, adding additional production capacity and sourcing of raw materials, as well as other terms and conditions customary for this type of agreement, including those regarding forecasting, purchasing, invoicing, representations, warranties and indemnities. Revenue attributable to these key components aggregating $3.0 million and cost of goods sold aggregating $2.0 million related to shipments to King that occurred in 2008 and the first quarter of 2009 was recognized in the third quarter of 2009 upon the execution of a long term supply agreement with King such that final terms and conditions of the sales were established.

Endo Pharmaceuticals Inc. (TRANSDUR-Sufentanil). In March 2005, we entered into a license agreement with Endo under which we granted to Endo the exclusive right to develop, market and commercialize TRANSDUR-Sufentanil in the U.S. and Canada. We received an initial payment of $10.0 million in connection with the execution of the agreement. In February 2009, Endo notified us that it was terminating the license agreement with us, and thereby returned their right to develop and commercialize TRANSDUR-Sufentanil in the U.S. and Canada to us effective August 26, 2009. As of December 31, 2009 and 2010, the cumulative aggregate payments received by us under this agreement were $21.5 million.

Table of Contents

EpiCept Corporation. In December 2006, we entered into a license agreement with EpiCept that provides us with the exclusive, worldwide license to certain of EpiCept s intellectual property for a transdermal patch containing bupivacaine for the treatment of back pain. In September 2008, the license was converted to an exclusive, worldwide, fully paid up, royalty-free, perpetual and irrevocable license for a transdermal patch containing bupivacaine under all fields of use covered by the EpiCept intellectual property. In consideration of the license, we paid EpiCept a cumulative amount of $3.25 million in full satisfaction of all future payment obligations to EpiCept under the license agreement.

NeuroSystec Corporation. In May 2004, we entered into an exclusive license agreement with NeuroSystec, a privately-held corporation founded by Alfred E. Mann, under which we granted to NeuroSystec exclusive worldwide rights to develop and commercialize products designed for the treatment of tinnitus and to improve post-operative recovery and tolerance of surgical implantation of cochlear devices using specified DURECT proprietary drug treatment methods and drug delivery technologies to deliver precise doses of appropriate medications directly to the middle or inner ear. The first development product is currently in early clinical development. We are responsible for formulation development of products utilizing our drug delivery platforms and manufacture and supply of product components consisting of our drug delivery platforms. We will receive certain milestone payments if certain development and commercialization milestones are achieved, as well as royalties based on product sales if products are commercialized under the agreement. This agreement will remain in effect until the expiration of NeuroSystec s royalty obligations under the agreement, which will occur when the last of our related patent rights expire or are found to be invalid, unless the agreement is otherwise terminated earlier. This agreement can be terminated by either party for material breach by the other party and by NeuroSystec without cause. In connection with the agreement, we received a minority equity ownership interest in NeuroSystec.

Commercial Businesses

ALZET

The ALZET product line consists of miniature, implantable osmotic pumps and accessories used for experimental research in mice, rats and other laboratory animals. These pumps are neither approved nor intended for human use. ALZET pumps continuously deliver drugs, hormones and other test agents at controlled rates from one day to four weeks without the need for external connections, frequent handling or repeated dosing. In laboratory research, these infusion pumps can be used for systemic administration when implanted under the skin or in the body. They can be attached to a catheter for intravenous, intracerebral, or intra-arterial infusion or for targeted delivery, where the effects of a drug or test agent are localized in a particular tissue or organ. The wide use and applications of the ALZET product line is evidenced by the more than 12,000 scientific references that now exist. We currently make and sell the ALZET product line on a worldwide basis. We market the ALZET product line through a direct sales force in the U.S. and through a network of distributors outside the U.S.

We acquired the ALZET product line and assets used primarily in the manufacture, sale and distribution of this product line from ALZA in April 2000. We believe that the ALZET business provides us with innovative design and application opportunities for potential new products.

LACTEL Absorbable Polymers

We currently design, develop and manufacture a wide range of standard and custom biodegradable polymers based on lactide, glycolide and caprolactone under the LACTEL brand for pharmaceutical and medical device clients for use as raw materials in their products. These materials are manufactured and sold by us directly from our facility in Alabama and are used by us and our third-party customers for a variety of controlled-release and medical-device applications, including several FDA-approved commercial products.

Table of Contents

Marketing and Sales

Historically, we have established strategic distribution and marketing alliances for our pharmaceutical systems to leverage the established sales organizations that certain pharmaceutical companies have in markets we are targeting. In the future, we may elect to build our own commercial, sales and marketing capability in order to capture more of the economic value of certain products that we may develop. If we choose to enter into third-party collaborations to commercialize our pharmaceutical systems, we may in the future enter into these alliances under circumstances that allow us to participate in the sales and marketing of these products. We will continue to pursue strategic alliances and collaborators from time to time consistent with our strategy to leverage the established sales organizations of third-party collaborators to achieve greater market penetration for some of our products than we could on our own. If we choose to enter into third-party collaborations to commercialize our pharmaceutical systems, we believe we have the flexibility to enter into these alliances under circumstances that allow us to retain greater economic participation because our pharmaceutical systems combine drugs for which medical data on efficacy and safety are available with proven technology platforms.

We market and sell our ALZET and LACTEL product lines through a direct sales force in the U.S. and through a network of distributors outside of the U.S.

Suppliers

We purchase sucrose acetate isobutyrate, a raw material for our ORADUR and SABER-based pharmaceutical systems, including POSIDUR, Remoxy and other ORADUR-based opioid drug candidates licensed to Pain Therapeutics, pursuant to a supply agreement with Eastman Chemical Company. We purchase sufentanil for TRANSDUR-Sufentanil pursuant to a supply agreement with Mallinckrodt, Inc. We have entered into a supply agreement with Corium International, Inc. for clinical and commercial supplies of ELADUR and a supply agreement with Hospira Worldwide, Inc. for clinical and commercial supplies of POSIDUR.

Our supply agreement with Eastman Chemical Company requires us to purchase a certain portion of our requirements for sucrose acetate isobutyrate from Eastman Chemical and obligates us to pay a fee per annum if our purchases do not meet specified sales targets. The agreement may be terminated by either party under certain circumstances, including any material uncured breach by, or the insolvency, liquidation or bankruptcy of, or similar proceedings involving, the other party.

Our supply agreement with Mallinckrodt, Inc. requires us to purchase a certain portion of our requirements for sufentanil from Mallinckrodt, and has no other minimum purchase requirements or exclusivity provisions. The initial term of the agreement expired on September 30, 2009 and is subject to automatic renewal for additional one-year terms unless either party provides one year notice of its intention not to renew the agreement. In addition, either party may terminate the Mallinckrodt agreement on 30 days notice for any material uncured breach by, or the bankruptcy of or similar proceedings involving, the other party. Finally, we may terminate the Mallinckrodt agreement on 60 days notice if we reasonably determine that the price being charged by Mallinckrodt is higher than the prevailing price for similar quantities of like grade or quality, or if we cease to develop or commercialize any products incorporating the products we purchase from Mallinckrodt.

We believe that these agreements will provide a sufficient supply of these raw materials and drug product to meet our needs for the foreseeable future. We do not have in place long term supply agreements with respect to all of the components of any of our pharmaceutical systems, however, and are subject to the risk that we may not be able to procure all required components in adequate quantities with acceptable quality, within acceptable time frames or at reasonable cost.

Customers

Our product revenues are derived from sale of the ALZET and LACTEL product lines as well as from the sale of certain key excipients that are included in Remoxy to our customer (King). Until such time that we are able to bring our pharmaceutical systems to market, if at all, we expect these to be our principal sources of product

Table of Contents

revenue. We also receive revenue from collaborative research and development arrangements with our third-party collaborators. In 2010, King and Hospira accounted for 33% and 18% of the Company s total revenues, respectively. In 2009, King accounted for 41% of our total revenues and no other customers accounted for more than 10% of total revenues. In 2008, revenues from our collaborative agreements with Pain Therapeutics, Nycomed, Endo, and Alpharma represented 22%, 16%, 14% and 12% of our total revenues, respectively.

At December 31, 2010, Hospira, King and Pain Therapeutics accounted for 33%, 19% and 15% of the Company s net accounts receivable, respectively. At December 31, 2009, Nycomed and King accounted for 39% and 11% of our net accounts receivable, respectively.

Manufacturing

The process for manufacturing our pharmaceutical systems is technically complex, requires special skills, and must be performed in a qualified facility. We have contracted with Hospira Worldwide and Corium International to manufacture clinical and commercial supplies of POSIDUR and ELADUR respectively. In addition, we have a small multi-discipline manufacturing facility in California that we have used to manufacture research and clinical supplies of several of our pharmaceutical systems under GMP, including POSIDUR, Remoxy, TRANSDUR-Sufentanil, and ELADUR. In the future, we intend to develop additional manufacturing capabilities for our pharmaceutical systems and components to meet our demands and those of our third party collaborators by contracting with third party manufacturers and by construction of additional manufacturing space at our current facilities in California and Alabama. We manufacture our ALZET product line and certain key components for Remoxy at one of our California facilities and our LACTEL product line at our Alabama facility.

Patents, Licenses and Proprietary Rights

Our success depends in part on our ability to obtain patents, to protect trade secrets, to operate without infringing upon the proprietary rights of others and to prevent others from infringing on our proprietary rights. Our policy is to seek to protect our proprietary position by, among other methods, filing U.S. and foreign patent applications related to our proprietary technology, inventions and improvements that are important to the development of our business. As of February 28, 2011, we held 60 issued U.S. patents and 468 issued foreign patents (which include granted European patent rights that have been validated in various EU member states). In addition, we have 79 pending U.S. patent applications and have filed 107 patent applications under the Patent Cooperation Treaty, from which 459 national phase applications are currently pending in Europe, Australia, Japan, Canada and other countries. Our patents expire at various dates starting in 2012.

Proprietary rights relating to our planned and potential products will be protected from unauthorized use by third parties only to the extent that they are covered by valid and enforceable patents or are effectively maintained as trade secrets. Patents owned by or licensed to us may not afford protection against competitors, and our pending patent applications now or hereafter filed by or licensed to us may not result in patents being issued. In addition, the laws of certain foreign countries may not protect our intellectual property rights to the same extent as do the laws of the U.S.

The patent positions of biopharmaceutical companies involve complex legal and factual questions and, therefore, their enforceability cannot be predicted with certainty. Our patents or patent applications, or those licensed to us, if issued, may be challenged, invalidated or circumvented, and the rights granted thereunder may not provide proprietary protection or competitive advantages to us against competitors with similar technology. Furthermore, our competitors may independently develop similar technologies or duplicate any technology developed by us. Because of the extensive time required for development, testing and regulatory review of a potential product, it is possible that, before any of our products can be commercialized, any related patent may expire or remain in existence for only a short period following commercialization, thus reducing any advantage of the patent, which could adversely affect our ability to protect future product development and, consequently, our operating results and financial position.

Table of Contents

Because patent applications in the U.S. are maintained in secrecy for at least 18 months after filing and since publication of discoveries in the scientific or patent literature often lag behind actual discoveries, we cannot be certain that we were the first to make the inventions covered by each of our issued or pending patent applications or that we were the first to file for protection of inventions set forth in such patent applications.

Our planned or potential products may be covered by third-party patents or other intellectual property rights, in which case we would need to obtain a license to continue developing or marketing these products. Any required licenses may not be available to us on acceptable terms, if at all. If we do not obtain any required licenses, we could encounter delays in product introductions while we attempt to design around these patents, or could find that the development, manufacture or sale of products requiring such licenses is foreclosed. Litigation may be necessary to defend against or assert such claims of infringement, to enforce patents issued to us, to protect trade secrets or know-how owned by us, or to determine the scope and validity of the proprietary rights of others. In addition, interference proceedings declared by the U.S. Patent and Trademark Office (USPTO) may be necessary to determine the priority of inventions with respect to our patent applications. Litigation or interference proceedings could result in substantial costs to and diversion of effort by us, and could have a material adverse effect on our business, financial condition and results of operations. These efforts by us may not be successful.

We may rely, in certain circumstances, on trade secrets to protect our technology. However, trade secrets are difficult to protect. We seek to protect our proprietary technology and processes, in part, by confidentiality agreements with our employees and certain contractors. There can be no assurance that these agreements will not be breached, that we will have adequate remedies for any breach, or that our trade secrets will not otherwise become known or be independently discovered by competitors. To the extent that our employees, consultants or contractors use intellectual property owned by others in their work for us, disputes may also arise as to the rights in related or resulting know-how and inventions.

Government Regulation

The Food and Drug Administration. The FDA and comparable regulatory agencies in state and local jurisdictions and in foreign countries impose substantial requirements upon the clinical development, manufacture and marketing of pharmaceutical products. These agencies and other federal, state and local entities regulate research and development activities and the testing, manufacture, quality control, safety, effectiveness, labeling, storage, distribution, record keeping, approval, advertising and promotion of our products. We believe that our initial pharmaceutical systems will be regulated as drugs by the FDA rather than as biologics or devices.

The process required by the FDA under the new drug provisions of the Federal Food, Drug and Cosmetics Act (the Act) before our initial pharmaceutical systems may be marketed in the U.S. generally involves the following:

- preclinical laboratory and animal tests;
- submission of an Investigational New Drug (IND) application which must become effective before clinical trials may begin;
- adequate and well-controlled human clinical trials to establish the safety and efficacy of the proposed pharmaceutical in our intended use; and
- FDA approval of a new drug application.

Section 505 of the Act describes three types of new drug applications: (1) an application that contains full reports of investigations of safety and effectiveness (section 505(b)(1)); (2) an application that contains full reports of investigations of safety and effectiveness but where at least some of the information required for approval comes from studies not conducted by or for the applicant and for which the applicant has not obtained a right of reference (section 505(b)(2)); and (3) an application that contains information to show that the proposed product is identical in active ingredient, dosage form, strength, route of administration, labeling, quality, performance characteristics and intended use, among other things, to a previously approved product (section

Table of Contents

505(j)). A supplement to an application is a new drug application. We expect that most of our drug candidates will be approved by submission of a new drug application under section 505(b)(2).

The testing and approval process requires substantial time, effort, and financial resources, and we cannot be certain that any approval will be granted on a timely basis, if at all. Even though several of our pharmaceutical systems utilize active drug ingredients that are commercially marketed in the United States in other dosage forms, we need to establish safety and effectiveness of those active ingredients in the formulation and dosage forms that we are developing.

Preclinical tests include laboratory evaluation of the product, its chemistry, formulation and stability, as well as animal studies to assess the potential safety and efficacy of the pharmaceutical system. We then submit the results of the preclinical tests, together with manufacturing information and analytical data, to the FDA as part of an IND, which must become effective before we may begin human clinical trials. Each subsequent new clinical protocol must also be submitted to the IND. An IND automatically becomes effective 30 days after receipt by the FDA, unless the FDA, within the 30-day time period, raises concerns or questions about the conduct of the trials as outlined in the IND and imposes a clinical hold. In such a case, the IND sponsor and the FDA must resolve any outstanding concerns before clinical trials can begin. Our submission of an IND may not result in FDA authorization to commence clinical trials. Further, an independent Institutional Review Board at each medical center proposing to conduct the clinical trials must review and approve any clinical study as well as the related informed consent forms and authorization forms that permit us to use individually identifiable health information of study participants.

Human clinical trials are typically conducted in three sequential phases which may overlap:

Phase I: The drug is initially introduced into healthy human subjects or patients and tested for safety, dosage tolerance, absorption, metabolism, distribution and excretion.

Phase II: Involves clinical trials in a limited patient population to identify possible adverse effects and safety risks, to determine the efficacy of the product for specific targeted diseases and to determine dosage tolerance and optimal dosage.

Phase III: When Phase II clinical trials demonstrate that a dosage range of the product is effective and has an acceptable safety profile, Phase III clinical trials are undertaken to further evaluate dosage, clinical efficacy and to further test for safety in an expanded patient population, at multiple, geographically dispersed clinical study sites.

In the case of products for severe diseases, such as chronic pain, or life-threatening diseases such as cancer, the initial human testing is often conducted in patients with disease rather than in healthy volunteers. Since these patients already have the target disease or condition, these studies may provide initial evidence of efficacy traditionally obtained in Phase II trials, and thus these trials are frequently referred to as Phase I/II clinical trials. We cannot be certain that we will successfully complete Phase I, Phase II or Phase III clinical trials of our pharmaceutical systems within any specific time period, if at all. Furthermore, the FDA or the Institutional Review Board or the sponsor may suspend clinical trials at any time on various grounds, including a finding that the subjects or patients are being exposed to an unacceptable health risk. During the clinical development of products, sponsors frequently meet and consult with the FDA in order to ensure that the design of their studies will likely provide data both sufficient and relevant for later regulatory approval; however, no assurance of approvability can be given by the FDA.

The results of product development, preclinical studies and clinical studies are submitted to the FDA as part of a new drug application, or NDA, for approval of the marketing and commercial shipment of the product. Submission of an NDA requires the payment of a substantial user fee to the FDA, and although the agency has defined user fee goals for the time in which to respond to sponsor applications, we cannot assure you that the FDA will act in any particular timeframe. The FDA may deny a new drug application if the applicable regulatory

Table of Contents

criteria are not satisfied or may require additional clinical data. Even if such data is submitted, the FDA may ultimately decide that the new drug application does not satisfy the criteria for approval. Once issued, the FDA may withdraw product approval if compliance with regulatory standards is not maintained or if safety problems occur after the product reaches the market. Requirements for additional Phase IV studies (post approval marketing studies) to confirm safety and effectiveness in a broader commercial use population may be imposed as a condition of marketing approval. In addition, the FDA requires surveillance programs to monitor approved products which have been commercialized, and the agency has the power to require changes in labeling or to prevent further marketing of a product based on the results of these post-marketing programs. Any comparative claims that we would like to make for our products vis-à-vis other dosage forms or products will need to be substantiated generally by two adequate and well-controlled head-to-head clinical trials.

Satisfaction of FDA requirements or similar requirements of state, local and foreign regulatory agencies typically takes several years and the actual time required may vary substantially, based upon the type, complexity and novelty of the pharmaceutical product. Government regulation may delay or prevent marketing of potential products for a considerable period of time and impose costly procedures upon our activities. We cannot be certain that the FDA or any other regulatory agency will grant approval for any of our pharmaceutical systems under development on a timely basis, if at all. Success in preclinical or early stage clinical trials does not assure success in later stage clinical trials. Data obtained from preclinical and clinical activities is not always conclusive and may be susceptible to varying interpretations which could delay, limit or prevent regulatory approval. Evolving safety concerns can result in the imposition of new requirements for expensive and time consuming tests, such as for QT interval cardiotoxicity testing. Even if a product receives regulatory approval, the approval may be significantly limited to specific indications. Further, even after regulatory approval is obtained, later discovery of previously unknown problems with a product may result in restrictions on the product or even complete withdrawal of the product from the market. Any pharmaceutical systems that we may develop and obtain approval for would also be subject to adverse findings of the active drug ingredients being marketed in different dosage forms and formulations. Delays in obtaining, or failures to obtain regulatory approvals would have a material adverse effect on our business. Marketing our pharmaceutical systems abroad will require similar regulatory approvals and is subject to similar risks. In addition, we cannot predict what adverse governmental regulations may arise from future U.S. or foreign governmental action.

Any pharmaceutical systems manufactured or distributed by us pursuant to FDA approvals are subject to pervasive and continuing regulation by the FDA, including record-keeping requirements and reporting of adverse experiences with the drug. Drug manufacturers and their subcontractors are required to register their establishments with the FDA and state agencies, and are subject to periodic unannounced inspections by the FDA and state agencies for compliance with good manufacturing practices, which impose procedural and documentation requirements upon us and our third party manufacturers. We cannot be certain that we or our present or future suppliers will be able to comply with the GMP regulations and other FDA regulatory requirements.

The FDA regulates drug labeling and promotion activities. The FDA has actively enforced regulations prohibiting the marketing of products for unapproved uses, and federal and state authorities are also actively litigating against sponsors who promote their drugs for unapproved uses under various fraud and abuse and false claims act statutes. We and our pharmaceutical systems are also subject to a variety of state laws and regulations in those states or localities where our pharmaceutical systems are or will be marketed. Any applicable state or local regulations may hinder our ability to market our pharmaceutical systems in those states or localities. We are also subject to numerous federal, state and local laws relating to such matters as safe working conditions, manufacturing practices, environmental protection, fire hazard control, and disposal of hazardous or potentially hazardous substances. We may incur significant costs to comply with such laws and regulations now or in the future.

The FDA s policies may change and additional government regulations may be enacted which could prevent or delay regulatory approval of our potential pharmaceutical systems. Moreover, increased attention to the

Table of Contents

containment of health care costs in the U.S. and in foreign markets could result in new government regulations that could have a material adverse effect on our business. We cannot predict the likelihood, nature or extent of adverse governmental regulation that might arise from future legislative or administrative action, either in the U.S. or abroad.

On February 6, 2009, the FDA sent letters to manufacturers of certain opioid drug products, indicating that these drugs will be required to have a Risk Evaluation and Mitigation Strategy (REMS) to ensure that the benefits of the drugs continue to outweigh the risks. The affected opioid drugs include brand name and generic products and are formulated with the active ingredients fentanyl, hydromorphone, methadone, morphine, oxycodone, and oxymorphone. The FDA has authority to require a REMS under the Food and Drug Administration Amendments Act of 2007 (FDAAA) when necessary to ensure that the benefits of a drug outweigh the risks.

According to the FDA, opioid drugs have benefit when used properly and are a necessary component of pain management for certain patients. Opioid drugs have serious risks when used improperly. The FDA, drug manufacturers, and others have taken a number of steps in the past to prevent misuse, abuse and accidental overdose of these drugs, including providing additional warnings in product labeling, implementing risk management plans, conducting inter-agency collaborations, and issuing direct communications to both prescribers and patients. Despite these efforts, the rates of misuse and abuse, and of accidental overdose of opioids, have risen over the past decade. The FDA believes that establishing a REMS for opioids will reduce these risks, while still ensuring that patients with legitimate need for these drugs will continue to have appropriate access.

According to the FDA, it recognizes the need to achieve balance between appropriate access and risk mitigation, and believes an effective strategy would benefit from input from industry, patient advocacy groups, the pain and addiction treatment communities, the general public, and other stakeholders. In the first of a series of meetings with stakeholders, the FDA invited those companies that market the affected opioid drugs to a meeting with the agency on March 3, 2009 to discuss REMS development. Additional steps will include discussions with other federal agencies and non-government institutions, including patient and consumer advocates, representatives of the pain and addiction treatment communities, other health care professionals, and other interested parties. The FDA also held a public meeting on May 27 and 28, 2009 to allow for broader public input and participation. On December 4, 2009, the FDA held a public meeting with the drug company sponsors to hear from them about the status of the development of a proposed REMS and their views regarding the specific features of the REMS. The FDA held an additional meeting on July 22 and 23, 2010 to solicit feedback from an advisory committee and the public on a proposal from the FDA for a class-wide opioid REMS. The FDA held an additional meeting on July 27 and 28, 2010 to solicit input from concerned parties regarding REMS for a broader class of pharmaceuticals (including but not limited to opioids). Through this process, the FDA hopes to gain valuable information that will lead to practical and effective solutions for development of a REMS and for appropriate use of these opioid drug products.

Many of our drug candidates including Remoxy, our other ORADUR-based opioid drug candidates and TRANSDUR-Sufentanil are subject to the REMS requirement. Until the contours of required REMS programs are established by the FDA and understood by drug developers and marketers such as ourselves and our collaborators, there may be delays in marketing approvals for these drug candidates. In addition, there may be increased cost, administrative burden and potential liability associated with the marketing and sale of these types of drug candidates subject to the REMS requirement, which could negatively impact the commercial benefits to us and our collaborators from the sale of these drug candidates.

The Drug Enforcement Administration. The Drug Enforcement Administration (DEA) regulates chemical compounds as Schedule I, II, III, IV or V substances, with Schedule I substances considered to present the highest risk of substance abuse and Schedule V substances the lowest risk. Certain active ingredients in TRANSDUR-Sufentanil, and Remoxy and our other ORADUR-based opioid drug candidates, are listed by the

Table of Contents

DEA as Schedule II under the Controlled Substances Act of 1970. Consequently, their manufacture, research, shipment, storage, sale and use are subject to a high degree of oversight and regulation. For example, all Schedule II drug prescriptions must be signed by a physician, physically presented to a pharmacist and may not be refilled without a new prescription. Furthermore, the amount of Schedule II substances we can obtain for clinical trials and commercial distribution is limited by the DEA and our quota may not be sufficient to complete clinical trials or meet commercial demand. There is a risk that DEA regulations may interfere with the supply of the drugs used in our clinical trials, and, in the future, our ability to produce and distribute our products in the volume needed to meet commercial demand.

Competition

We may face competition from other companies in numerous industries including pharmaceuticals, medical devices and drug delivery. POSIDUR, TRANSDUR-Sufentanil, ELADUR, Remoxy and other ORADUR-based drug candidates, if approved, will compete with currently marketed oral opioids, transdermal opioids, local anesthetic patches, stimulants, implantable and external infusion pumps which can be used for infusion of opioids and local anesthetics. Products of these types are marketed by Purdue Pharma, King, Knoll, Janssen, Medtronic, Endo, AstraZeneca, Arrow International, Tricumed, I-Flow (Kimberly-Clark), Cumberland Pharmaceuticals, NeurogesX, Covidien, Shire, Johnson & Johnson, Eli Lilly, Pfizer, Novartis and others. Numerous companies are applying significant resources and expertise to the problems of drug delivery and several of these are focusing or may focus on delivery of drugs to the intended site of action, including Alkermes, Pacira Pharmaceuticals, EpiCept, Innocoll, Nektar, I-Flow (Kimberly-Clark), NeurogesX, Flamel, Alexza, Cadence Pharmaceuticals, Hospira, Cumberland Pharmaceuticals, Egalet, Acura and others. Some of these competitors may be addressing the same therapeutic areas or indications as we are. Our current and potential competitors may succeed in obtaining patent protection or commercializing products before us. Many of these entities have significantly greater research and development capabilities than we do, as well as substantially more marketing, manufacturing, financial and managerial resources. These entities represent significant competition for us. Acquisitions of, or investments in, competing pharmaceutical or biotechnology companies by large corporations could increase such competitors financial, marketing, manufacturing and other resources.

Any products we develop using our pharmaceutical systems technologies will compete in highly competitive markets. Many of our potential competitors in these markets have greater development, financial, manufacturing, marketing, and sales resources than we do and we cannot be certain that they will not succeed in developing products or technologies which will render our technologies and products obsolete or noncompetitive. In addition, many of those potential competitors have significantly greater experience than we do in their respective fields.

Corporate History, Headquarters and Website Information

We were incorporated in Delaware in February 1998. We completed our initial public offering on September 28, 2000. Our principal executive offices are located at 2 Results Way, Cupertino, California, 95014. Our telephone number is (408) 777-1417, and our web site address is www.durect.com. We make our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to these reports available free of charge on our web site as soon as reasonably practicable after we file these reports with the Securities and Exchange Commission. Our Code of Ethics can be found on our website.

Employees

As of February 28, 2011 we had 131 employees, including 77 in research and development, 25 in manufacturing and 29 in selling, general and administrative. From time to time, we also employ independent contractors to support our research, development and administrative organizations. None of our employees are represented by a collective bargaining unit, and we have never experienced a work stoppage. We consider our relations with our employees to be good.

Table of Contents

Executive Officers of the Registrant

Our executive officers and their ages as of February 28, 2011 are as follows:

Name	Age	Position
Felix Theeuwes, D.Sc.	73	Chairman, Chief Scientific Officer and Director
James E. Brown, D.V.M.	54	President, Chief Executive Officer and Director
Matthew J. Hogan, M.B.A.	51	Chief Financial Officer
Joseph Stauffer, D.O., M.B.A.	44	Chief Medical Officer and Executive Vice President, Corporate Strategy
Jean I Liu, J.D., M.S.	42	Chief Legal Officer and Secretary
Paula Mendenhall, Pharm.D.	67	Executive Vice President, Operations and Administration
Su Il Yum, Ph.D.	71	Executive Vice President, Pharmaceutical Systems Research and Development

Felix Theeuwes, D.Sc. co-founded DURECT in February 1998 and has served as our Chairman, Chief Scientific Officer and a Director since July 1998. Prior to that, Dr. Theeuwes held various positions at ALZA Corporation, including President of New Ventures from August 1997 to August 1998, President of ALZA Research and Development from 1995 to August 1997, President of ALZA Technology Institute from 1994 to April 1995 and Chief Scientist from 1982 to June 1997. Dr. Theeuwes holds a D.Sc. degree in Physics from the University of Leuven (Louvain), Belgium. He also served as a post-doctoral fellow and visiting research assistant professor in the Department of Chemistry at the University of Kansas and has completed the Stanford Executive Program.

James E. Brown, D.V.M. co-founded DURECT in February 1998 and has served as our President, Chief Executive Officer and a Director since June 1998. He previously worked at ALZA Corporation as Vice President of Biopharmaceutical and Implant Research and Development from June 1995 to June 1998. Prior to that, Dr. Brown held various positions at Syntex Corporation, a pharmaceutical company, including Director of Business Development from May 1994 to May 1995, Director of Joint Ventures for Discovery Research from April 1992 to May 1995, and held a number of positions including Program Director for Syntex Research and Development from October 1985 to March 1992. Dr. Brown holds a B.A. from San Jose State University and a D.V.M. (Doctor of Veterinary Medicine) from the University of California, Davis where he also conducted post-graduate work in pharmacology and toxicology.

Matthew J. Hogan, M.B.A. has served as our Chief Financial Officer since September 2006. He was the Chief Financial Officer at Ciphergen Biosystems, Inc. from 2000 to 2006, and a consultant from March 2006. Prior to joining Ciphergen, Mr. Hogan was the Chief Financial Officer at Avocet Medical, Inc. from 1999 to 2000. From 1996 to 1999, Mr. Hogan was the Chief Financial Officer at Microcide Pharmaceuticals, Inc. From 1986 to 1996, he held various positions in the investment banking group at Merrill Lynch & Co., most recently as a Director focusing on the biotechnology and pharmaceutical sectors. Mr. Hogan holds a B.A. in economics from Dartmouth College and an M.B.A. from the Amos Tuck School of Business Administration.

Joseph Stauffer, D.O., M.B.A. joined DURECT in June 2009 as Chief Medical Officer and Executive Vice President, Corporate Strategy. Prior to joining DURECT, Dr. Stauffer was at Alpharma Inc. from 2004 to 2009, where his latest position was as Chief Medical Officer and Senior Vice President of Clinical Research & Medical Affairs. Prior to joining Alpharma, Dr. Stauffer was employed at Abbott Laboratories from 2002 to 2004 as Global Medical Director. Prior to Abbott, he worked at the FDA from 2000 to 2002 as a Medical Review Officer in the Analgesic Division of the Center for Drug Evaluation and Research. Dr. Stauffer is a founding member of the Initiative on Methods, Measurement and Pain Assessment in Clinical Trials (IMMPACT). This on-going collaboration between pharma, FDA, NIH, academia and patient advocacy groups helps to develop core domains and outcomes for chronic pain clinical trials. Dr. Stauffer graduated from the Philadelphia College of Osteopathic Medicine and completed residency training in Anesthesiology at the Johns Hopkins University Hospital, where he is currently an Adjunct Assistant Professor in the Department of Anesthesiology and Critical Care Medicine. Dr. Stauffer is a veteran of the U.S. Navy, honorably discharged as a Lieutenant Commander after serving eight years as a Naval Medical Officer. He completed his MBA in September 2009 as part of the TRIUM Global

Table of Contents

Executive MBA Program, a joint degree granted by NYU Stern School of Business, HEC School of Management (Paris) and the London School of Economics and Political Science.

Jean I Liu, J.D., M.S. has served as our Chief Legal Officer since December 2010 and served as our Senior Vice President and General Counsel since February 2003. She was appointed Secretary of the corporation in March 2004. She served as our Vice President of Legal and General Counsel from February 1999 to February 2003. Previously, from October 1998, Ms. Liu served as our Vice President of Legal. Prior to that, Ms. Liu worked as an attorney at Venture Law Group, a law firm, from May 1997 to October 1998. Ms. Liu worked as an attorney at Pillsbury Madison & Sutro LLP, a law firm, from September 1993 to May 1997. Ms. Liu holds a B.S. in Cellular & Molecular Biology from University of Michigan, an M.S. in Biology from Stanford University and a J.D. from Columbia University School of Law. Ms. Liu is a member of the State Bar of California and is admitted to practice before the USPTO.

Paula Mendenhall, Pharm.D. has served as our Executive Vice President of Operations and Administration since January 2007 and as Senior Vice President of Operations since January 2005. Prior to joining DURECT, Dr. Mendenhall was an independent consultant for various pharmaceutical companies for in-house and outsourcing of pharmaceutical manufacturing, including development of manufacturing strategies and plans and development and training of personnel. From 1997 to 2000, Dr. Mendenhall served as Vice President, Group Vice President and President of Oread Pharmaceutical Manufacturing at Oread Inc. From 1979 to 1997, Dr. Mendenhall served in a variety of roles for Hoffmann-La Roche Inc./Syntex, including in the areas of manufacturing, quality assurance, finance, planning and facilities, as well as provided technical assistance and support to Syntex Global Operations for marketed products and new product launches. Dr. Mendenhall received a Pharm D. degree from the University of California, San Francisco, and is a member of the American Association of Pharmaceutical Scientists (AAPS) and the Parenteral Drugs Association.

Su Il Yum, Ph.D. has served as our Executive Vice President of Pharmaceutical Systems Research and Development since January 2007 and as our Senior Vice President of Pharmaceutical Systems Research and Development since January 2006. Previously, Dr. Yum served as our Senior Vice President, Engineering since December 2003 and as our Vice President of Engineering from December 1999 to December 2003. Prior to joining DURECT, Dr. Yum served as Senior Technical Advisor at Amira Medical in Scotts Valley, California, where he participated in the development of a pain-free blood glucose detector called AtLast®. Prior to joining Amira, he held a number of senior positions in project management and engineering at ALZA Corporation for 27 years. Dr. Yum earned his Ph.D. degree in Chemical Engineering from the University of Minnesota, and completed a Post-doctoral research in Biomedical Engineering at the University of Utah. Dr. Yum is a Fellow of the AAPS.

Item 1A. Risk Factors.

In addition to the other information in this Form 10-K, a number of factors may affect our business and prospects. These factors include but are not limited to the following, which you should consider carefully in evaluating our business and prospects.

Risks Related To Our Business

Development of our pharmaceutical systems is not complete, and we cannot be certain that our pharmaceutical systems will be able to be commercialized

To be profitable, we or our third-party collaborators must successfully research, develop, obtain regulatory approval for, manufacture, introduce, market and distribute our pharmaceutical systems under development. For each pharmaceutical system that we or our third-party collaborators intend to commercialize, we must successfully meet a number of critical developmental milestones for each disease or medical condition targeted, including:

selecting and developing drug delivery platform technology to deliver the proper dose of drug over the desired period of time;

Table of Contents

determining the appropriate drug dosage for use in the pharmaceutical system;

developing drug compound formulations that will be tolerated, safe and effective and that will be compatible with the system;

demonstrating the drug formulation will be stable for commercially reasonable time periods;

demonstrating through clinical trials that the drug and system combination is safe and effective in patients for the intended indication; and

completing the manufacturing development and scale-up to permit manufacture of the pharmaceutical system in commercial quantities and at acceptable prices.

The time frame necessary to achieve these developmental milestones for any individual product is long and uncertain, and we may not successfully complete these milestones for any of our products in development. We have not yet selected the drug dosages nor finalized the formulation or the system design of POSIDUR, TRANSDUR-Sufentanil, ELADUR and our ORADUR-based drug candidates other than Remoxy, and we have limited experience in developing such products. We may not be able to finalize the design or formulation of any of these pharmaceutical systems. In addition, we may select components, solvents, excipients or other ingredients to include in our pharmaceutical systems that have not been previously approved for use in pharmaceutical products, which may require us or our collaborators to perform additional studies and may delay clinical testing and regulatory approval of our pharmaceutical systems. Even after we complete the design of a pharmaceutical system, the pharmaceutical system must still complete required clinical trials and additional safety testing in animals before approval for commercialization. We are continuing testing and development of our pharmaceutical systems and may explore possible design or formulation changes to address issues of safety, manufacturing efficiency and performance. We and our collaborators may not be able to complete development of any pharmaceutical systems that will be safe and effective and that will have a commercially reasonable treatment and storage period. If we or our third-party collaborators are unable to complete development of POSIDUR, TRANSDUR-Sufentanil, ELADUR, Remoxy and our ORADUR-based drug candidates other than Remoxy, or other pharmaceutical systems, we will not be able to earn revenue from them, which would materially harm our business.

We or our third-party collaborators must show the safety and efficacy of our drug candidates in animal studies and human clinical trials to the satisfaction of regulatory authorities before they can be sold

Before we or our third-party collaborators can obtain government approval to sell any of our pharmaceutical systems, we or they, as applicable, must demonstrate through laboratory performance studies and safety testing, nonclinical (animal) studies and clinical (human) trials that each system is safe and effective for human use for each targeted indication. The clinical development status of our most advanced publicly announced development programs is as follows:

Remoxy In December 2010, King resubmitted the NDA in response to a Complete Response Letter received in December 2008; this is a Class II resubmission and the FDA has indicated a June 23, 2011 PDUFA goal date. There can be no assurance that the resubmission of the NDA by King (now Pfizer) will receive timely review or be sufficient to gain approval of Remoxy.

POSIDUR To date, we have completed multiple Phase II studies in various surgeries and held an end-of-Phase II meeting with the FDA. We are currently conducting BESST (Bupivacaine Effectiveness and Safety in SABER Trial), which is intended to be the pivotal Phase III clinical trial in the U.S. BESST is an international, multi-center, randomized, double-blind, controlled trial evaluating the safety, efficacy, and pharmacokinetics of POSIDUR in approximately 300 patients undergoing a variety of general abdominal surgical procedures. There can be no assurance that this trial will be successful. Furthermore, there can be no assurance that our planned development program for POSIDUR will generate data and information that will be deemed sufficient for marketing approval by the FDA or other regulatory agencies.

Table of Contents

TRANSDUR-Sufentanil Patch In February 2009, an end-of-Phase II meeting with the FDA was conducted for this program outlining a potential regulatory pathway for the Phase III program and NDA submission. During 2009, we transitioned the program back to our control from Endo Pharmaceuticals. We are in discussions with potential partners regarding licensing development and commercialization rights to this program to which we hold worldwide rights. There can be no assurance that our planned development program for TRANSDUR-Sufentanil will generate data and information that will be deemed sufficient for marketing approval by the FDA or other regulatory agencies or that we will be able to find a collaborator with respect to the development and commercialization of this drug candidate.

ELADUR A Phase IIa clinical trial was completed and positive results were reported in the fourth quarter of 2007. King, to whom we have granted worldwide development and commercialization rights for ELADUR, is conducting a Phase IIb clinical trial to evaluate ELADUR for the treatment of chronic low back pain and we expect to have top-line data from that study in the first half of 2011. There can be no assurance that King (now Pfizer) will be able to successfully develop ELADUR to obtain marketing approval by the FDA or other regulatory agencies.

ORADUR-based opioids Phase I clinical trials have been conducted for two of these ORADUR-based products (hydrocodone and hydromorphone), and an IND has been accepted by the FDA for the third ORADUR-based opioid (oxymorphone). There can be no assurance that we will be able to successfully develop ORADUR-based formulations of hydrocodone, hydromorphone or oxymorphone to obtain marketing approval by the FDA or other regulatory agencies.

ORADUR-ADHD In July 2010, we commenced a Phase I study to evaluate multiple formulations of ORADUR-ADHD. There can be no assurance that we will be able to successfully develop ORADUR-ADHD to obtain marketing approval by the FDA or other regulatory agencies.

We are currently in the clinical, preclinical or research stages with respect to all our other pharmaceutical systems under development. We plan to continue extensive and costly tests, clinical trials and safety studies in animals to assess the safety and effectiveness of our pharmaceutical systems. These studies include laboratory performance studies and safety testing, clinical trials and animal toxicological studies necessary to support regulatory approval of development products in the United States and other countries of the world. These studies are costly, complex and last for long durations, and may not yield data supportive of the safety or efficacy of our drug candidates or required for regulatory approval.

While some of our clinical trials described above have shown indications of safety and efficacy of our product candidates, there can be no assurance that these results will be confirmed in subsequent clinical trials. In addition, side effects observed in clinical trials, or other side effects that appear in later clinical trials, may adversely affect our or our collaborators ability to obtain regulatory approval or market our product candidates. Side effects, toxicity or other safety issues associated with the use of our drug candidates that could require us to perform additional studies or halt development of our drug candidates. We and our collaborators may not be permitted to begin or continue our planned clinical trials for our potential pharmaceutical systems. If our trials are permitted, our potential pharmaceutical systems may not prove to be safe or produce their intended effects. In addition, we or our collaborators may be required by regulatory agencies to conduct additional animal or human studies regarding the safety and efficacy of our pharmaceutical systems which we have not planned or anticipated. For example, according to Pain Therapeutics, the FDA has indicated that additional non-clinical data will be required prior to regulatory approval for Remoxy. Although the NDA was resubmitted by King to the FDA in December 2010 in response to a Complete Response Letter, there can be no assurance that the FDA will view the data contained in the resubmission as adequate for approval and may require additional or new data prior to approval, in which case the time required to generate such data may delay commercialization of Remoxy and harm our business and financial condition.

The length of clinical trials will depend upon, among other factors, the rate of trial site and patient enrollment and the number of patients required to be enrolled in such studies. We or our third-party collaborators may fail to obtain adequate levels of patient enrollment in our clinical trials. Delays in planned patient enrollment

Table of Contents

may result in increased costs, delays or termination of clinical trials, which could have a material adverse effect on us. In addition, even if we or our third-party collaborators enroll the number of patients we expect in the time frame we expect, such clinical trials may not provide the data necessary to support regulatory approval for the pharmaceutical systems for which they were conducted. Additionally, we or our third-party collaborators may fail to effectively oversee and monitor these clinical trials, which would result in increased costs or delays of our clinical trials. Even if these clinical trials are completed, we or our third-party collaborators may fail to complete and submit a new drug application as scheduled.

The FDA may not clear any such application in a timely manner or may deny the application entirely. Data already obtained from preclinical studies and clinical trials of our pharmaceutical systems do not necessarily predict the results that will be obtained from later preclinical studies and clinical trials. Moreover, preclinical and clinical data such as ours are susceptible to varying interpretations, which could delay, limit or prevent regulatory approval. A number of companies in the pharmaceutical industry have suffered significant setbacks in advanced clinical trials, even after promising results in earlier trials. The failure to adequately demonstrate the safety and effectiveness of a pharmaceutical system under development to the satisfaction of FDA and other regulatory agencies could delay or prevent regulatory clearance of the potential pharmaceutical system, resulting in delays to the commercialization of our pharmaceutical system, and could materially harm our business. Clinical trials may not demonstrate the sufficient levels of safety and efficacy necessary to obtain the requisite regulatory approvals for our pharmaceutical systems, and thus our pharmaceutical systems may not be approved for marketing.

Regulatory action or failure to obtain product approvals could delay or limit development and commercialization of our pharmaceutical systems and result in failure to achieve anticipated revenues

The manufacture and marketing of our pharmaceutical systems and our research and development activities are subject to extensive regulation for safety, efficacy and quality by numerous government authorities in the United States and abroad. We or our third-party collaborators must obtain clearance or approval from applicable regulatory authorities before we or they, as applicable, can perform clinical trials, market or sell our products in development in the United States or abroad. Clinical trials, manufacturing and marketing of products are subject to the rigorous testing and approval process of the FDA and equivalent foreign regulatory authorities. In particular, recent recalls of and reported adverse side effects of marketed drugs have made regulatory agencies, including the FDA, increasingly focus on the safety of drug products. Regulatory agencies are requiring more extensive and ever increasing showings of safety at every stage of drug development and commercialization from initial clinical trials to regulatory approval and beyond. These rigorous and evolving standards may delay and increase the expenses of our development efforts. The FDA or other foreign regulatory agency may, at any time, halt our and our collaborators development and commercialization activities due to safety concerns, in which case our business will be harmed. In addition, the FDA or other foreign regulatory agency may refuse or delay approval of our or our collaborators drug candidates for failure to collect sufficient clinical or animal safety data, and require us or our collaborators to conduct additional clinical or animal safety data which may cause lengthy delays and increased costs to our programs.

The Federal Food, Drug and Cosmetic Act and other federal, state and foreign statutes and regulations govern and influence the testing, manufacture, labeling, advertising, distribution and promotion of drugs and medical devices. These laws and regulations are complex and subject to change. Furthermore, these laws and regulations may be subject to varying interpretations, and we may not be able to predict how an applicable regulatory body or agency may choose to interpret or apply any law or regulation to our pharmaceutical systems. As a result, clinical trials and regulatory approval can take a number of years to accomplish and require the expenditure of substantial resources. We or our third-party collaborators, as applicable, may encounter delays or rejections based upon administrative action or interpretations of current rules and regulations. We or our third-party collaborators, as applicable, may not be able to timely reach agreement with the FDA on our clinical trials or on the required clinical or animal data we or they must collect to continue with our clinical trials or eventually commercialize our pharmaceutical systems.

Table of Contents

We or our third-party collaborators, as applicable, may also encounter delays or rejections based upon additional government regulation from future legislation, administrative action or changes in FDA policy during the period of product development, clinical trials and FDA regulatory review. We or our third-party collaborators, as applicable, may encounter similar delays in foreign countries. Sales of our pharmaceutical systems outside the United States are subject to foreign regulatory standards that vary from country to country.

The time required to obtain approvals from foreign countries may be shorter or longer than that required for FDA approval, and requirements for foreign licensing may differ from FDA requirements. We or our third-party collaborators, as applicable, may be unable to obtain requisite approvals from the FDA and foreign regulatory authorities, and even if obtained, such approvals may not be on a timely basis, or they may not cover the clinical uses that we specify. If we or our third-party collaborators, as applicable, fail to obtain timely clearance or approval for our development products, we or they will not be able to market and sell our pharmaceutical systems, which will limit our ability to generate revenue.

Many of our drug candidates under development including Remoxy, our other ORADUR-based opioids and TRANSDUR-Sufentanil are subject to mandatory Risk Evaluation and Mitigation Strategy (REMS) programs, a new requirement by the FDA, which could delay the approval of these drug candidates and increase the cost, burden and liability associated with the commercialization of these drug candidates

On February 6, 2009, the FDA sent letters to manufacturers of certain opioid drug products, indicating that these drugs will be required to have a Risk Evaluation and Mitigation Strategy (REMS) to ensure that the benefits of the drugs continue to outweigh the risks. The affected opioid drugs include brand name and generic products and are formulated with the active ingredients fentanyl, hydromorphone, methadone, morphine, oxycodone, and oxymorphone. The FDA has authority to require a REMS under the Food and Drug Administration Amendments Act of 2007 (FDAAA) when necessary to ensure that the benefits of a drug outweigh the risks.

According to the FDA, opioid drugs have benefit when used properly and are a necessary component of pain management for certain patients. Opioid drugs have serious risks when used improperly. The FDA, drug manufacturers, and others have taken a number of steps in the past to prevent misuse, abuse and accidental overdose of these drugs, including providing additional warnings in product labeling, implementing risk management plans, conducting inter-agency collaborations, and issuing direct communications to both prescribers and patients. Despite these efforts, the rates of misuse and abuse, and of accidental overdose of opioids, have risen over the past decade. The FDA believes that establishing a REMS for opioids will reduce these risks, while still ensuring that patients with legitimate need for these drugs will continue to have appropriate access.

According to the FDA, it recognizes the need to achieve balance between appropriate access and risk mitigation, and believes an effective strategy would benefit from input from industry, patient advocacy groups, the pain and addiction treatment communities, the general public, and other stakeholders. In the first of a series of meetings with stakeholders, the FDA invited those companies that market the affected opioid drugs to a meeting with the agency on March 3, 2009 to discuss REMS development. Additional steps will include discussions with other federal agencies and non-government institutions, including patient and consumer advocates, representatives of the pain and addiction treatment communities, other health care professionals, and other interested parties. The FDA also held public meetings on May 27 and 28, 2009 to allow for broader public input and participation. On December 4, 2009, FDA held a public meeting with the drug company sponsors to hear from them about the status of the development of a proposed REMS and their views regarding the specific features of the REMS. The FDA held an additional meeting on July 22 and 23, 2010 to solicit feedback from an advisory committee and the public on a proposal from the FDA for a class-wide opioid REMS. The FDA held another meeting on July 27 and 28, 2010 to solicit input from concerned parties regarding REMS for a broader class of pharmaceuticals (including but not limited to opioids). Through this process, the FDA hopes to gain valuable information that will lead to practical and effective solutions for development of a REMS and for appropriate use of these opioid drug products.

Table of Contents

Many of our drug candidates including Remoxy, our other ORADUR-opioid drug candidates and TRANSDUR-Sufentanil are subject to the REMS requirement. Until the contours of required REMS programs are established by the FDA and understood by drug developers and marketers such as ourselves and our collaborators, there may be delays in marketing approvals for these drug candidates. In addition, there may be increased cost, administrative burden and potential liability associated with the marketing and sale of these types of drug candidates subject to the REMS requirement, which could negatively impact the commercial benefits to us and our collaborators from the sale of these drug candidates.

We depend to a large extent on third-party collaborators, and we have limited or no control over the development, sales, distribution and disclosure for our pharmaceutical systems which are the subject of third-party collaborative or license agreements

Our performance depends to a large extent on the ability of our third-party collaborators to successfully develop and obtain approvals for our pharmaceutical systems. We have entered into agreements with Pain Therapeutics, Hospira, Nycomed, Alpharma (acquired by King which in turn has been acquired by Pfizer), Orient Pharma and others under which we granted such third parties the right to develop, apply for regulatory approval for, market, promote or distribute Remoxy and other ORADUR-based products, POSIDUR, ELADUR and other product candidates, respectively, subject to payments to us in the form of product royalties and other payments. We have limited or no control over the expertise or resources that any collaborator may devote to the development, clinical trial strategy, regulatory approval, marketing or sale of these pharmaceutical systems, or the timing of their activities. Any of our present or future collaborators may not perform their obligations as expected. These collaborators may breach or terminate their agreement with us or otherwise fail to conduct their collaborative activities successfully and in a timely manner. Enforcing any of these agreements in the event of a breach by the other party could require the expenditure of significant resources and consume a significant amount of management time and attention. Our collaborators may also conduct their activities in a manner that is different from the manner we would have chosen, had we been developing such pharmaceutical systems ourselves. Further, our collaborators may elect not to develop or commercialize pharmaceutical systems arising out of our collaborative arrangements or not devote sufficient resources to the development, clinical trials, regulatory approval, manufacture, marketing or sale of these pharmaceutical systems. If any of these events occur, we may not recognize revenue from the commercialization of our pharmaceutical systems based on such collaborations. In addition, these third parties may have similar or competitive products to the ones which are the subject of their collaborations with us, or relationships with our competitors, which may reduce their interest in developing or selling our pharmaceutical systems. We may not be able to control public disclosures made by some of our third-party collaborators, which could negatively impact our stock price.

Our near-term revenues depend on collaboration agreements with other companies. These agreements subject us to obligations which must be fulfilled and also make our revenues dependent on the performance of such third parties. If we are unable to meet our obligations or manage our relationships with our collaborators under these agreements or enter into additional collaboration agreements or if our existing collaborations are terminated, our revenues may decrease. Acquisitions of our partners can be disruptive

Our near-term revenues are based to a significant extent on collaborative arrangements with third parties, pursuant to which we receive payments based on our performance of research and development activities set forth in these agreements. We may not be able to fulfill our obligations or attain milestones set forth in any specific agreement, which could cause our revenues to fluctuate or be less than anticipated and may expose us to liability for contractual breach. In addition, these agreements may require us to devote significant time and resources to communicating with and managing our relationships with such collaborators and resolving possible issues of contractual interpretation which may detract from time our management would otherwise devote to managing our operations. Such agreements are generally complex and contain provisions that could give rise to legal disputes, including potential disputes concerning ownership of intellectual property under collaborations. Such disputes can delay or prevent the development of potential new pharmaceutical systems, or can lead to lengthy, expensive litigation or arbitration. In general, our collaboration agreements, including our agreements

Table of Contents

with Pain Therapeutics with respect to Remoxy and other ORADUR-based products incorporating specified opioids, Hospira and Nycomed with respect to POSIDUR, Alpharma (acquired by King which in turn has been acquired by Pfizer) with respect to ELADUR and Orient Pharma with respect to ORADUR-ADHD, may be terminated by the other party at will or upon specified conditions including, for example, if we fail to satisfy specified performance milestones or if we breach the terms of the agreement. From time to time, our licensees may be the subject of an acquisition by another company. For example, Alpharma was acquired by King in December 2008 and in February 2011 King was acquired by Pfizer. Such transactions can lead to turnover of program staff, a review of development programs and strategies by the acquirer, and other events that can disrupt a program, resulting in program delays or discontinuations.

If any of our collaborative agreements are terminated or delayed, our revenues may be reduced or not materialize, and our products in development related to those agreements may not be commercialized.

Our revenues will likely differ from our cash flows from revenue-generating activities. Upfront payments received upon execution of collaborative agreements are recorded as deferred revenue and recognized on a straight-line basis over the period of our continuing involvement with the third-party collaborator pursuant to the applicable agreement. As of December 31, 2010, we have $42.9 million of deferred revenue, which will be recognized in future periods and may cause our reported revenues to be greater than cash flows from our ongoing revenue-generating activities.

Our near-term revenues also depend on milestone payments based on achievements by our third-party collaborators. Failure of such collaborators to attain such milestones would result in our not receiving additional revenues

In addition to payments based on our performance of research and development activities, our revenues also depend on the attainment of milestones set forth in our collaboration agreements. Such milestones are typically related to clinical trial developments, regulatory approvals or sales accomplishments. To the extent third-party collaborators do not achieve such milestones, we will not receive the associated revenues, which could harm our financial condition and may cause us to defer or cut-back development activities or forego the exploitation of opportunities in certain geographic territories, any of which could have a material adverse effect on our business.

Our business strategy includes the entry into additional collaborative agreements. We may not be able to enter into additional collaborative agreements or may not be able to negotiate commercially acceptable terms for these agreements

Our current business strategy includes the entry into additional collaborative agreements for the development and commercialization of our pharmaceutical systems. The negotiation and consummation of these type of agreements typically involve simultaneous discussions with multiple potential collaborators and require significant time and resources from our officers, business development, legal, and research and development staff. In addition, in attracting the attention of pharmaceutical and biotechnology company collaborators, we compete with numerous other third parties with product opportunities as well the collaborators own internal product opportunities. We may not be able to consummate additional collaborative agreements, or we may not be able to negotiate commercially acceptable terms for these agreements. If we do not consummate additional collaborative agreements, we may have to consume money more rapidly on our product development efforts, defer development activities or forego the exploitation of certain geographic territories, any of which could have a material adverse effect on our business.

We may have difficulty raising needed capital in the future

Our business currently does not generate sufficient revenues to meet our capital requirements and we do not expect that it will do so in the near future. We have expended and will continue to expend substantial funds to complete the research, development and clinical testing of our pharmaceutical systems. We will require

Table of Contents

additional funds for these purposes, to establish additional clinical- and commercial-scale manufacturing arrangements and facilities and to provide for the marketing and distribution of our pharmaceutical systems. Additional funds may not be available on acceptable terms, if at all. If adequate funds are unavailable from operations or additional sources of financing, we may have to delay, reduce the scope of or eliminate one or more of our research or development programs which would materially harm our business, financial condition and results of operations.

In July 2010, we entered into an equity line of credit facility with Azimuth under which we may sell to Azimuth, subject to certain limitations, up to $50 million of our common stock over a 24-month period. Azimuth will not be obligated to purchase shares under the equity line of credit unless specified conditions are met. If we are unable to meet the specified conditions with respect to any sale of shares under the Azimuth equity line of credit, we may be unable to access this source of financing. Azimuth is also permitted to terminate the equity line of credit under certain circumstances.

We believe that our cash, cash equivalents and investments, will be adequate to satisfy our capital needs for at least the next 12 months. However, our actual capital requirements will depend on many factors, including:

- continued progress and cost of our research and development programs;
- the continuation of our collaborative agreements that provide financial funding for our activities;
- success in entering into collaboration agreements and meeting milestones under such agreements;
- progress with preclinical studies and clinical trials;
- the time and costs involved in obtaining regulatory clearance;
- costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims;
- costs of developing sales, marketing and distribution channels and our ability and that of our collaborators to sell our pharmaceutical systems;
- costs involved in establishing manufacturing capabilities for clinical and commercial quantities of our pharmaceutical systems;
- competing technological and market developments;
- market acceptance of our pharmaceutical systems;
- costs for recruiting and retaining employees and consultants; and
- unexpected legal, accounting and other costs and liabilities related to our business.

We may consume available resources more rapidly than currently anticipated, resulting in the need for additional funding. We may seek to raise any necessary additional funds through equity or debt financings, convertible debt financings, collaborative arrangements with corporate collaborators or other sources, which may be dilutive to existing stockholders and may cause the price of our common stock to decline. In addition, in the event that additional funds are obtained through arrangements with collaborators or other sources, we may have to relinquish rights to some of our technologies or pharmaceutical systems that we would otherwise seek to develop or commercialize ourselves. If adequate funds are not available, we may be required to significantly reduce or refocus our product development efforts, resulting in loss of sales, increased costs, and reduced revenues.

Table of Contents

We and our third-party collaborators may not be able to manufacture sufficient quantities of our pharmaceutical systems and components to support the clinical and commercial requirements of our collaborators and ourselves at an acceptable cost or in compliance with applicable government regulations, and we have limited manufacturing experience

We or our third-party collaborators to whom we have assigned such responsibility must manufacture our pharmaceutical systems and components in clinical and commercial quantities, either directly or through third parties, in compliance with regulatory requirements and at an acceptable cost. The manufacturing processes associated with our pharmaceutical systems are complex. Except with respect to Remoxy, we and our third-party collaborators, where relevant, have not yet completed development of the manufacturing process for any pharmaceutical systems or components, including POSIDUR, TRANSDUR-Sufentanil, ELADUR, and our other ORADUR-based drug candidates. If we and our third-party collaborators, where relevant, fail to timely complete the development of the manufacturing process for our pharmaceutical systems, we and our third-party collaborators, where relevant, will not be able to timely produce product for clinical trials and commercialization of our pharmaceutical systems. We have also committed to manufacture and supply pharmaceutical systems or components under a number of our collaborative agreements with third-party companies. We have limited experience manufacturing pharmaceutical products, and we may not be able to timely accomplish these tasks. If we and our third-party collaborators, where relevant, fail to develop manufacturing processes to permit us to manufacture a pharmaceutical system or component at an acceptable cost, then we and our third-party collaborators may not be able to commercialize that pharmaceutical system or we may be in breach of our supply obligations to our third-party collaborators.

Our manufacturing facility in Cupertino is a multi-disciplinary site that we have used to manufacture only research and clinical supplies of several of our pharmaceutical systems under good manufacturing practices (GMP), including POSIDUR, TRANSDUR-Sufentanil, ELADUR, Remoxy and other ORADUR-based drug candidates. We have not manufactured commercial quantities of any of our pharmaceutical systems. In the future, we intend to develop additional manufacturing capabilities for our pharmaceutical systems and components to meet our demands and those of our third-party collaborators by contracting with third-party manufacturers and by construction of additional manufacturing space at our facilities in California and Alabama. We have limited experience building and validating manufacturing facilities, and we may not be able to accomplish these tasks in a timely manner.

If we and our third-party collaborators, where relevant, are unable to manufacture pharmaceutical systems or components in a timely manner or at an acceptable cost, quality or performance level, and are unable to attain and maintain compliance with applicable regulations, the clinical trials and the commercial sale of our pharmaceutical systems and those of our third-party collaborators could be delayed. Additionally, we may need to alter our facility design or manufacturing processes, install additional equipment or do additional construction or testing in order to meet regulatory requirements, optimize the production process, increase efficiencies or production capacity or for other reasons, which may result in additional cost to us or delay production of product needed for the clinical trials and commercial launch of our pharmaceutical systems and those of our third-party collaborators.

We have entered into a supply agreement with Corium International, Inc. for clinical and commercial supplies of ELADUR and a supply agreement with Hospira Worldwide, Inc. for clinical and commercial supplies of POSIDUR. These third parties are currently our sole source for drug product required for development and commercialization of these drug candidates. Furthermore, we and our third-party collaborators, where relevant, may also need or choose to subcontract with additional third-party contractors to perform manufacturing steps of our pharmaceutical systems or supply required components for our pharmaceutical systems. Where third party contractors perform manufacturing services for us, we will be subject to the schedule, expertise and performance of third parties as well as incur significant additional costs. Failure of third parties to perform their obligations could adversely affect our operations, development timeline and financial results.

Table of Contents

If we or our third-party collaborators cannot manufacture pharmaceutical systems or components in time to meet the clinical or commercial requirements of our collaborators or ourselves or at an acceptable cost, our operating results will be harmed.

Failure to comply with ongoing governmental regulations for our pharmaceutical systems could materially harm our business in the future

Marketing or promoting a drug is subject to very strict controls. Furthermore, clearance or approval may entail ongoing requirements for post-marketing studies. The manufacture and marketing of drugs are subject to continuing FDA and foreign regulatory review and requirements that we update our regulatory filings. Later discovery of previously unknown problems with a product, manufacturer or facility, or our failure to update regulatory files, may result in restrictions, including withdrawal of the product from the market. Any of the following or other similar events, if they were to occur, could delay or preclude us from further developing, marketing or realizing full commercial use of our pharmaceutical systems, which in turn would materially harm our business, financial condition and results of operations:

- failure to obtain or maintain requisite governmental approvals;
- failure to obtain approvals for clinically intended uses of our pharmaceutical systems under development; or
- FDA required product withdrawals or warnings arising from identification of serious and unanticipated adverse side effects in our pharmaceutical systems.

Manufacturers of drugs must comply with the applicable FDA good manufacturing practice regulations, which include production design controls, testing, quality control and quality assurance requirements as well as the corresponding maintenance of records and documentation. Compliance with current good manufacturing practices regulations is difficult and costly. Manufacturing facilities are subject to ongoing periodic inspection by the FDA and corresponding state agencies, including unannounced inspections, and must be licensed before they can be used for the commercial manufacture of our development products. We and/or our present or future suppliers and distributors may be unable to comply with the applicable good manufacturing practice regulations and other FDA regulatory requirements. We have not been subject to a good manufacturing regulation inspection by the FDA relating to our pharmaceutical systems. If we, our third-party collaborators or our respective suppliers do not achieve compliance for our pharmaceutical systems we or they manufacture, the FDA may refuse or withdraw marketing clearance or require product recall, which may cause interruptions or delays in the manufacture and sale of our pharmaceutical systems.

We have a history of operating losses, expect to continue to have losses in the future and may never achieve or maintain profitability

We have incurred significant operating losses since our inception in 1998 and, as of December 31, 2010, had an accumulated deficit of approximately $336.8 million. We expect to continue to incur significant operating losses over the next several years as we continue to incur significant costs for research and development, clinical trials, manufacturing, sales, and general and administrative functions. Our ability to achieve profitability depends upon our ability, alone or with others, to successfully complete the development of our proposed pharmaceutical systems, obtain the required regulatory clearances, and manufacture and market our proposed pharmaceutical systems. Development of pharmaceutical systems is costly and requires significant investment. In addition, we may choose to license from third parties either additional drug delivery platform technology or rights to particular drugs or other appropriate technology for use in our pharmaceutical systems. The license fees for these technologies or rights would increase the costs of our pharmaceutical systems.

To date, we have not generated significant revenue from the commercial sale of our pharmaceutical systems and do not expect to do so in the near future. Our current revenues are from the sale of the ALZET product line, the sale of LACTEL biodegradable polymers and certain excipient sales, and from payments under collaborative

Table of Contents

research and development agreements with third parties. We do not expect our product revenues to increase significantly in the near future, and we do not expect that collaborative research and development revenues will exceed our actual operating expenses. We do not anticipate meaningful revenues to derive from the commercialization and marketing of our pharmaceutical systems in development in the near future, and therefore do not expect to generate sufficient revenues to cover expenses or achieve profitability in the near future.

We may develop our own sales force to market future products but we have limited sales experience and may not be able to do so effectively

We may choose to develop our own sales force to market in the United States products that we may develop in the future. Developing a sales force will require substantial expenditures. We have limited sales and marketing experience, and may not be able to effectively recruit, train or retain sales personnel. We may not be able to effectively sell our pharmaceutical systems, if approved, and our failure to do so could limit or materially harm our business.

We and our third-party collaborators may not sell our pharmaceutical systems effectively

We and our third-party collaborators compete with many other companies that currently have extensive and well-funded marketing and sales operations. Our marketing and sales efforts and those of our third-party collaborations may be unable to compete successfully against these other companies. We and our third-party collaborators, if relevant, may be unable to establish a sufficient sales and marketing organization on a timely basis, if at all. We and our third-party collaborators, if relevant, may be unable to engage qualified distributors. Even if engaged, these distributors may:

- fail to satisfy financial or contractual obligations to us;
- fail to adequately market our pharmaceutical systems;
- cease operations with little or no notice to us;
- offer, design, manufacture or promote competing product lines;
- fail to maintain adequate inventory and thereby restrict use of our pharmaceutical systems; or
- build up inventory in excess of demand thereby limiting future purchases of our pharmaceutical systems resulting in significant quarter-to-quarter variability in our sales.

The failure of us or our third-party collaborators to effectively develop, gain regulatory approval for, sell, manufacture and market our pharmaceutical systems will hurt our business and financial results.

We rely heavily on third parties to support development, clinical testing and manufacturing of our pharmaceutical systems

We rely on third-party contract research organizations, service providers and suppliers to provide critical services to support development, clinical testing, and manufacturing of our pharmaceutical systems. For example, we currently depend on third-party vendors to manage and monitor our clinical trials and to perform critical manufacturing steps for our pharmaceutical systems. These third parties may not execute their responsibilities and tasks competently or in a timely fashion. We rely on third-parties to manufacture or perform manufacturing steps relating to our pharmaceutical systems or components. We anticipate that we will continue to rely on these and other third-party contractors to support development, clinical testing, and manufacturing of our pharmaceutical systems. Failure of these contractors to provide the required services in a competent or timely manner or on reasonable commercial terms could materially delay the development and approval of our development products, increase our expenses and materially harm our business, financial condition and results of operations.

37

Table of Contents

Key components of our pharmaceutical systems are provided by limited numbers of suppliers, and supply shortages or loss of these suppliers could result in interruptions in supply or increased costs

Certain components and drug substances used in our pharmaceutical systems (including POSIDUR, TRANSDUR-Sufentanil, ELADUR, Remoxy and our other ORADUR-based drug candidates) are currently purchased from a single or a limited number of outside sources. In particular, Eastman Chemical is the sole supplier, pursuant to a supply agreement entered into in December 2005, of our requirements of sucrose acetate isobutyrate, a necessary component of POSIDUR, Remoxy, our other ORADUR-based drug candidates and certain other pharmaceuticals systems we have under development. The reliance on a sole or limited number of suppliers could result in:

- delays associated with redesigning a pharmaceutical system due to a failure to obtain a single source component;
- an inability to obtain an adequate supply of required components; and
- reduced control over pricing, quality and delivery time.

We have supply agreements in place for certain components of our pharmaceuticals systems, but do not have in place long term supply agreements with respect to all of the components of any of our pharmaceutical system candidates. Therefore the supply of a particular component could be terminated at any time without penalty to the supplier. In addition, we may not be able to procure required components or drugs from third-party suppliers at a quantity, quality and cost acceptable to us. Any interruption in the supply of single source components could cause us to seek alternative sources of supply or manufacture these components internally. Furthermore, in some cases, we are relying on our third-party collaborators to procure supply of necessary components. If the supply of any components for our pharmaceutical systems is interrupted, components from alternative suppliers may not be available in sufficient volumes or at acceptable quality levels within required timeframes, if at all, to meet our needs or those of our third-party collaborators. This could delay our ability to complete clinical trials and obtain approval for commercialization and marketing of our pharmaceutical systems, causing us to lose sales, incur additional costs, delay new product introductions and could harm our reputation.

If we are unable to adequately protect, maintain or enforce our intellectual property rights or secure rights to third-party patents, we may lose valuable assets, experience reduced market share or incur costly litigation to protect our rights or our third-party collaborators may choose to terminate their agreements with us

Our success will depend in part on our ability to obtain and maintain patents, maintain trade secret protection and operate without infringing the proprietary rights of others. As of February 28, 2011, we held 60 issued U.S. patents and 468 issued foreign patents (which include granted European patent rights that have been validated in various EU member states). In addition, we have 79 pending U.S. patent applications and have filed 107 patent applications under the Patent Cooperation Treaty, from which 459 national phase applications are currently pending in Europe, Australia, Japan, Canada and other countries. Our patents expire at various dates starting in 2012.

The patent positions of pharmaceutical companies, including ours, are uncertain and involve complex legal and factual questions. In addition, the coverage claimed in a patent application can be significantly reduced before the patent is issued. Consequently, our patent applications or those that are licensed to us may not issue into patents, and any issued patents may not provide protection against competitive technologies or may be held invalid if challenged or circumvented. Our competitors may also independently develop products similar to ours or design around or otherwise circumvent patents issued to us or licensed by us. In addition, the laws of some foreign countries may not protect our proprietary rights to the same extent as U.S. law.

The patent laws of the U.S. have recently undergone changes through court decisions which may have significant impact on us and our industry. The recent decisions of the U.S. Supreme Court (e.g., *KSR v. Teleflex, eBay v. MercExchange*) and other courts (e.g., *In re Seagate*) with respect to the standards of patentability,

Table of Contents

enforceability, availability of injunctive relief and damages may make it more difficult for us to procure, maintain and enforce patents. In addition, bills are pending before the U.S. Congress that may fundamentally change the patent laws of the U.S. on issues ranging from priority entitlement, filing and prosecution matters to enforcement and damages. These changes and proposed reforms have introduced significant uncertainty in the patent law landscape and may potentially negatively impact our ability to procure, maintain and enforce patents to provide exclusivity for our products.

We are party to several collaborative agreements. Our third-party collaborators have entered into these agreements based on the exclusivity that our intellectual property rights confer on the products being developed. The loss or diminution of our intellectual property rights could result in a decision by our third-party collaborators to terminate their agreements with us. In addition, these agreements are generally complex and contain provisions that could give rise to legal disputes, including potential disputes concerning ownership of intellectual property and data under collaborations. Such disputes can lead to lengthy, expensive litigation or arbitration requiring us to devote management time and resources to such dispute which we would otherwise spend on our business. To the extent that our agreements call for future royalties to be paid conditional on our having patents covering the royalty-bearing subject matter, the decision by the Supreme Court in the case of *MedImmune v. Genentech* could encourage our licensees to challenge the validity of our patents and thereby seek to avoid future royalty obligations without losing the benefit of their license. Should they be successful in such a challenge, our ability to collect future royalties could be substantially diminished.

We also rely upon trade secrets, technical know-how and continuing technological innovation to develop and maintain our competitive position. We require our employees, consultants, advisors and collaborators to execute appropriate confidentiality and assignment-of-inventions agreements with us. These agreements typically provide that all materials and confidential information developed or made known to the individual during the course of the individual s relationship with us is to be kept confidential and not disclosed to third parties except in specific circumstances, and that all inventions arising out of the individual s relationship with us will be our exclusive property. These agreements may be breached, and in some instances, we may not have an appropriate remedy available for breach of the agreements. Furthermore, our competitors may independently develop substantially equivalent proprietary information and techniques, reverse engineer our information and techniques, or otherwise gain access to our proprietary technology.

We may be unable to meaningfully protect our rights in trade secrets, technical know-how and other non-patented technology. We may have to resort to litigation to protect our intellectual property rights, or to determine their scope, validity or enforceability. In addition, interference proceedings declared by the USPTO may be necessary to determine the priority of inventions with respect to our patent applications. Enforcing or defending our proprietary rights is expensive, could cause diversion of our resources and may not prove successful. Any failure to enforce or protect our rights could cause us to lose the ability to exclude others from using our technology to develop or sell competing products.

We may be sued by third parties which claim that our pharmaceutical systems infringe on their intellectual property rights, particularly because there is substantial uncertainty about the validity and breadth of medical patents

We and our collaborators may be exposed to future litigation by third parties based on claims that our pharmaceutical systems or activities infringe the intellectual property rights of others or that we or our collaborators have misappropriated the trade secrets of others. This risk is exacerbated by the fact that the validity and breadth of claims covered in medical technology patents and the breadth and scope of trade secret protection involve complex legal and factual questions for which important legal principles are unresolved. Any litigation or claims against us or our collaborators, whether or not valid, could result in substantial costs, could place a significant strain on our financial resources and could harm our reputation. We also may not have sufficient funds to litigate against parties with substantially greater resources. In addition, pursuant to our collaborative agreements, we have provided our collaborators with the right, under specified circumstances, to

Table of Contents

defend against any claims of infringement of the third party intellectual property rights, and such collaborators may not defend against such claims adequately or in the manner that we would do ourselves. Intellectual property litigation or claims could force us or our collaborators to do one or more of the following, any of which could harm our business or financial results:

- cease selling, incorporating or using any of our pharmaceutical systems that incorporate the challenged intellectual property, which would adversely affect our revenue;
- obtain a license from the holder of the infringed intellectual property right, which license may be costly or may not be available on reasonable terms, if at all; or
- redesign our pharmaceutical systems, which would be costly and time-consuming.

We may be required to obtain rights to certain drugs

Some of the pharmaceutical systems that we may choose to develop may include proprietary drugs to which we do not have commercial rights. To complete the development and commercialization of pharmaceutical systems containing drugs to which we do not have commercial rights, we will be required to obtain rights to those drugs. We may not be able to do this at an acceptable cost, if at all. If we are not able to obtain required rights to commercialize certain drugs, we may not be able to complete the development of pharmaceutical systems which require use of those drugs. This could result in the cessation of certain development projects and the potential write-off of certain assets.

Technologies and businesses which we have acquired may be difficult to integrate, disrupt our business, dilute stockholder value or divert management attention. We may also acquire additional businesses or technologies in the future, which could have these same effects

We may acquire technologies, products or businesses to broaden the scope of our existing and planned product lines and technologies. Future acquisitions expose us to:

- increased costs associated with the acquisition and operation of the new businesses or technologies and the management of geographically dispersed operations;
- the risks associated with the assimilation of new technologies, operations, sites and personnel;
- the diversion of resources from our existing business and technologies;
- the inability to generate revenues to offset associated acquisition costs;
- the requirement to maintain uniform standards, controls, and procedures; and
- the impairment of relationships with employees and customers or third party collaborators as a result of any integration of new management personnel.

Acquisitions may also result in the issuance of dilutive equity securities, the incurrence or assumption of debt or additional expenses associated with the amortization of acquired intangible assets or potential businesses. Past acquisitions, such as our acquisitions of IntraEAR, ALZET, SBS and APT, as well as future acquisitions, may not generate any additional revenue or provide any benefit to our business.

Some of our pharmaceutical systems contain controlled substances, the making, use, sale, importation and distribution of which are subject to regulation by state, federal and foreign law enforcement and other regulatory agencies

Some of our pharmaceutical systems currently under development contain, and our products in the future may contain, controlled substances which are subject to state, federal and foreign laws and regulations regarding their manufacture, use, sale, importation and distribution. The TRANSDUR-Sufentanil patch, Remoxy and our

Table of Contents

other ORADUR-based drug candidates, and other pharmaceutical systems we have under development contain active ingredients which are classified as controlled substances under the regulations of the U.S. Drug Enforcement Agency. For our pharmaceutical systems containing controlled substances, we and our suppliers, manufacturers, contractors, customers and distributors are required to obtain and maintain applicable registrations from state, federal and foreign law enforcement and regulatory agencies and comply with state, federal and foreign laws and regulations regarding the manufacture, use, sale, importation and distribution of controlled substances. These regulations are extensive and include regulations governing manufacturing, labeling, packaging, testing, dispensing, production and procurement quotas, record keeping, reporting, handling, shipment and disposal. These regulations increase the personnel needs and the expense associated with development and commercialization of drug candidates including controlled substances. Failure to obtain and maintain required registrations or comply with any applicable regulations could delay or preclude us from developing and commercializing our pharmaceutical systems containing controlled substances and subject us to enforcement action. In addition, because of their restrictive nature, these regulations could limit our commercialization of our pharmaceutical systems containing controlled substances. In particular, among other things, there is a risk that these regulations may interfere with the supply of the drugs used in our clinical trials, and in the future, our ability to produce and distribute our products in the volume needed to meet commercial demand.

Write-offs related to the impairment of long-lived assets, inventories and other non-cash charges, as well as stock-based compensation expenses may adversely impact or delay our profitability

We may incur significant non-cash charges related to impairment write-downs of our long-lived assets, including goodwill and other intangible assets. We will continue to incur non-cash charges related to amortization of other intangible assets. For example, we had a $13.5 million non-cash write-down of deferred royalties and commercial rights related to CHRONOGESIC in the fourth quarter of 2008, which impacted our financial statements. We are required to perform periodic impairment reviews of our goodwill at least annually. To the extent these reviews conclude that the expected future cash flows generated from our business activities are not sufficient to recover the cost of our long-lived assets, we will be required to measure and record an impairment charge to write-down these assets to their realizable values. We completed our last review during the fourth quarter of 2010 and determined that goodwill was not impaired as of December 31, 2010. However, there can be no assurance that upon completion of subsequent reviews a material impairment charge will not be recorded. If future periodic reviews determine that our assets are impaired and a write-down is required, it will adversely impact or delay our profitability.

Inventories include certain excipients that are sold to a customer and included in products awaiting regulatory approval. These inventories are capitalized based on management s judgment of probable sale prior to their expiration date which in turn is based on non-binding forecasts from our customer. The valuation of inventory requires us to estimate the value of inventory that may become expired prior to use. We may be required to expense previously capitalized inventory costs upon a change in our judgment, due to, among other potential factors, a denial or delay of approval of our customer s product by the necessary regulatory bodies, or new information that suggests that the inventory will not be saleable. In addition, these circumstances may cause us to record a liability related to minimum purchase agreements that we have in place for raw materials.

Global credit and financial market conditions could negatively impact the value of our current portfolio of cash equivalents, short-term investments or long-term investments and our ability to meet our financing objectives

Our cash and cash equivalents are maintained in highly liquid investments with remaining maturities of 90 days or less at the time of purchase. Our short-term investments consist primarily of readily marketable debt securities with original maturities of greater than 90 days from the date of purchase but remaining maturities of less than one year from the balance sheet date. Our long-term investments consist primarily of readily marketable debt securities with maturities in one year or beyond from the balance sheet date. While as of the date of this

Table of Contents

filing, we are not aware of any downgrades, material losses, or other significant deterioration in the fair value of our cash equivalents, short-term investments or long-term investments since December 31, 2010, no assurance can be given that deterioration in conditions of the global credit and financial markets would not negatively impact our current portfolio of cash equivalents, short-term investments or long-term investments or our ability to meet our financing objectives.

We depend upon key personnel who may terminate their employment with us at any time, and we may need to hire additional qualified personnel

Our success will depend to a significant degree upon the continued services of key management, technical and scientific personnel, including Felix Theeuwes, our Chairman and Chief Scientific Officer and James E. Brown, our President and Chief Executive Officer. In addition, our success will depend on our ability to attract and retain other highly skilled personnel. Competition for qualified personnel is intense, and the process of hiring and integrating such qualified personnel is often lengthy. We may be unable to recruit such personnel on a timely basis, if at all. Our management and other employees may voluntarily terminate their employment with us at any time. The loss of the services of key personnel, or the inability to attract and retain additional qualified personnel, could result in delays to product development or approval, loss of sales and diversion of management resources.

We may not successfully manage our company through varying business cycles

Our success will depend on properly sizing our company through growth and contraction cycles caused in part by changing business conditions, which places a significant strain on our management and on our administrative, operational and financial resources. To manage through such cycles, we must expand or contract our facilities, our operational, financial and management systems and our personnel. If we were unable to manage growth and contractions effectively our business would be harmed.

Our business involves environmental risks and risks related to handling regulated substances

In connection with our research and development activities and our manufacture of materials and pharmaceutical systems, we are subject to federal, state and local laws, rules, regulations and policies governing the use, generation, manufacture, storage, air emission, effluent discharge, handling and disposal of certain materials, biological specimens and wastes. Although we believe that we have complied with the applicable laws, regulations and policies in all material respects and have not been required to correct any material noncompliance, we may be required to incur significant costs to comply with environmental and health and safety regulations in the future. Our research and development involves the use, generation and disposal of hazardous materials, including but not limited to certain hazardous chemicals, solvents, agents and biohazardous materials. The extent of our use, generation and disposal of such substances has increased substantially since we started manufacturing and selling biodegradable polymers. Although we believe that our safety procedures for storing, handling and disposing of such materials comply with the standards prescribed by state and federal regulations, we cannot completely eliminate the risk of accidental contamination or injury from these materials. We currently contract with third parties to dispose of these substances generated by us, and we rely on these third parties to properly dispose of these substances in compliance with applicable laws and regulations. If these third parties do not properly dispose of these substances in compliance with applicable laws and regulations, we may be subject to legal action by governmental agencies or private parties for improper disposal of these substances. The costs of defending such actions and the potential liability resulting from such actions are often very large. In the event we are subject to such legal action or we otherwise fail to comply with applicable laws and regulations governing the use, generation and disposal of hazardous materials and chemicals, we could be held liable for any damages that result, and any such liability could exceed our resources.

Table of Contents

Our corporate headquarters, manufacturing facilities and personnel are located in a geographical area that is seismically active

Our corporate headquarters, primary manufacturing facilities and personnel are located in a geographical area that is known to be seismically active and prone to earthquakes. Should such a natural disaster occur, our ability to conduct our business could be severely restricted, and our business and assets, including the results of our research, development and manufacturing efforts, could be destroyed.

Risks Related To Our Industry

The market for our pharmaceutical systems is rapidly changing and competitive, and new products or technologies developed by others could impair our ability to grow our business and remain competitive

The pharmaceutical industry is subject to rapid and substantial technological change. Developments by others may render our pharmaceutical systems under development or technologies noncompetitive or obsolete, or we may be unable to keep pace with technological developments or other market factors. Technological competition in the industry from pharmaceutical and biotechnology companies, universities, governmental entities and others diversifying into the field is intense and is expected to increase.

We may face competition from other companies in numerous industries including pharmaceuticals, medical devices and drug delivery. POSIDUR, TRANSDUR-Sufentanil, ELADUR, Remoxy and other ORADUR-based drug candidates, if approved, will compete with currently marketed oral opioids, transdermal opioids, local anesthetic patches, stimulants, implantable and external infusion pumps which can be used for infusion of opioids and local anesthetics. Products of these types are marketed by Purdue Pharma, King, Knoll, Janssen, Medtronic, Endo, AstraZeneca, Arrow International, Tricumed, I-Flow (Kimberly-Clark), Cumberland Pharmaceuticals, NeurogesX, Covidien, Shire, Johnson & Johnson, Eli Lilly, Pfizer, Novartis and others. Numerous companies are applying significant resources and expertise to the problems of drug delivery and several of these are focusing or may focus on delivery of drugs to the intended site of action, including Alkermes, Pacira Pharmaceuticals, EpiCept, Innocoll, Nektar, I-Flow (Kimberly-Clark), NeurogesX, Flamel, Alexza, Cadence Pharmaceuticals, Hospira, Cumberland Pharmaceuticals, Egalet, Acura and others. Some of these competitors may be addressing the same therapeutic areas or indications as we are. Our current and potential competitors may succeed in obtaining patent protection or commercializing products before us. Many of these entities have significantly greater research and development capabilities than we do, as well as substantially more marketing, manufacturing, financial and managerial resources. These entities represent significant competition for us. Acquisitions of, or investments in, competing pharmaceutical or biotechnology companies by large corporations could increase such competitors financial, marketing, manufacturing and other resources.

We are engaged in the development of novel therapeutic technologies. Our resources are limited and we may experience technical challenges inherent in such novel technologies. Competitors have developed or are in the process of developing technologies that are, or in the future may be, the basis for competitive products. Some of these products may have an entirely different approach or means of accomplishing similar therapeutic effects than our pharmaceutical systems. Our competitors may develop products that are safer, more effective or less costly than our pharmaceutical systems and, therefore, present a serious competitive threat to our product offerings.

The widespread acceptance of therapies that are alternatives to ours may limit market acceptance of our pharmaceutical systems even if commercialized. Chronic and post-operative pain are currently being treated by oral medication, transdermal drug delivery systems, such as drug patches, and implantable drug delivery devices which will be competitive with our pharmaceutical systems. These treatments are widely accepted in the medical community and have a long history of use. The established use of these competitive products may limit the potential for our pharmaceutical systems to receive widespread acceptance if commercialized.

Table of Contents

We could be exposed to significant product liability claims which could be time consuming and costly to defend, divert management attention and adversely impact our ability to obtain and maintain insurance coverage

The testing, manufacture, marketing and sale of our pharmaceutical systems involve an inherent risk that product liability claims will be asserted against us. Although we are insured against such risks up to an annual aggregate limit in connection with clinical trials and commercial sales of our pharmaceutical systems, our present product liability insurance may be inadequate and may not fully cover the costs of any claim or any ultimate damages we might be required to pay. Product liability claims or other claims related to our pharmaceutical systems, regardless of their outcome, could require us to spend significant time and money in litigation or to pay significant damages. Any successful product liability claim may prevent us from obtaining adequate product liability insurance in the future on commercially desirable or reasonable terms. In addition, product liability coverage may cease to be available in sufficient amounts or at an acceptable cost. An inability to obtain sufficient insurance coverage at an acceptable cost or otherwise to protect against potential product liability claims could prevent or inhibit the commercialization of our pharmaceutical systems. A product liability claim could also significantly harm our reputation and delay market acceptance of our pharmaceutical systems.

Acceptance of our pharmaceutical systems in the marketplace is uncertain, and failure to achieve market acceptance will delay our ability to generate or grow revenues

Our future financial performance will depend upon the successful introduction and customer acceptance of our future products, including POSIDUR, TRANSDUR-Sufentanil, ELADUR, Remoxy and other ORADUR-based drug candidates. Even if approved for marketing, our pharmaceutical systems may not achieve market acceptance. The degree of market acceptance will depend upon a number of factors, including:

- the receipt of regulatory clearance of marketing claims for the uses that we are developing;
- the establishment and demonstration in the medical community of the safety and clinical efficacy of our products and their potential advantages over existing therapeutic products, including oral medication, transdermal drug delivery products such as drug patches, or external or implantable drug delivery products; and
- pricing and reimbursement policies of government and third-party payors such as insurance companies, health maintenance organizations, hospital formularies and other health plan administrators.

Physicians, patients, payors or the medical community in general may be unwilling to accept, utilize or recommend any of our products. If we are unable to obtain regulatory approval, commercialize and market our future products when planned and achieve market acceptance, we will not achieve anticipated revenues.

If users of our products are unable to obtain adequate reimbursement from third-party payors, or if new restrictive legislation is adopted, market acceptance of our products may be limited and we may not achieve anticipated revenues

The continuing efforts of government and insurance companies, health maintenance organizations and other payors of healthcare costs to contain or reduce costs of health care may affect our future revenues and profitability, and the future revenues and profitability of our potential customers, suppliers and third-party collaborators and the availability of capital. For example, in certain foreign markets, pricing or profitability of prescription pharmaceuticals is subject to government control. In the United States, recent federal and state government initiatives have been directed at lowering the total cost of health care, and the U.S. Congress and state legislatures will likely continue to focus on health care reform, the cost of prescription pharmaceuticals and on the reform of the Medicare and Medicaid systems. While we cannot predict whether any such legislative or regulatory proposals will be adopted, the announcement or adoption of such proposals could materially harm our business, financial condition and results of operations.

The successful commercialization of our pharmaceutical systems will depend in part on the extent to which appropriate reimbursement levels for the cost of our pharmaceutical systems and related treatment are obtained

Table of Contents

by governmental authorities, private health insurers and other organizations, such as HMOs. Third-party payors are increasingly limiting payments or reimbursement for medical products and services. Also, the trend toward managed health care in the United States and the concurrent growth of organizations such as HMOs, which could control or significantly influence the purchase of health care services and products, as well as legislative proposals to reform health care or reduce government insurance programs, may limit reimbursement or payment for our products. The cost containment measures that health care payors and providers are instituting and the effect of any health care reform could materially harm our ability to operate profitably.

If we or our third-party collaborators are unable to train physicians to use our pharmaceutical systems to treat patients diseases or medical conditions, we may incur delays in market acceptance of our products

Broad use of our pharmaceutical systems will require extensive training of numerous physicians on the proper and safe use of our pharmaceutical systems. The time required to begin and complete training of physicians could delay introduction of our products and adversely affect market acceptance of our products. We or third parties selling our pharmaceutical systems may be unable to rapidly train physicians in numbers sufficient to generate adequate demand for our pharmaceutical systems. Any delay in training would materially delay the demand for our pharmaceutical systems and harm our business and financial results. In addition, we may expend significant funds towards such training before any orders are placed for our products, which would increase our expenses and harm our financial results.

Potential new accounting pronouncements and legislative actions are likely to impact our future financial position or results of operations

Future changes in financial accounting standards may cause adverse, unexpected fluctuations in the timing of the recognition of revenues or expenses and may affect our financial position or results of operations. New pronouncements and varying interpretations of pronouncements have occurred with frequency and may occur in the future and we may make changes in our accounting policies in the future. Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses. Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations, PCAOB pronouncements and NASDAQ rules, are creating uncertainty for companies such as ours and insurance, accounting and auditing costs are increasing as a result of this uncertainty and other factors. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, we intend to invest all reasonably necessary resources to comply with evolving standards, and this investment may result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

Risks Related To Our Common Stock

Our operating history makes evaluating our stock difficult

Our quarterly and annual results of operations have historically fluctuated and we expect will continue to fluctuate for the foreseeable future. We believe that period-to-period comparisons of our operating results should not be relied upon as predictive of future performance. Our prospects must be considered in light of the risks, expenses and difficulties encountered by companies with no approved pharmaceutical products, particularly companies in new and rapidly evolving markets such as pharmaceuticals, drug delivery and biotechnology. To address these risks, we must, among other things, obtain regulatory approval for and commercialize our pharmaceutical systems, which may not occur. We may not be successful in addressing these risks and difficulties. We may require additional funds to complete the development of our pharmaceutical systems and to fund operating losses to be incurred in the next several years.

Table of Contents

Investors may experience substantial dilution of their investment

Investors may experience dilution of their investment if we raise capital through the sale of additional equity securities or convertible debt securities or grant additional stock options to employees and consultants. Any sales in the public market of the common stock issuable upon such conversion could adversely affect prevailing market prices for our common stock.

The price of our common stock may be volatile

The stock markets in general, and the markets for pharmaceutical stocks in particular, have experienced extreme volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our common stock.

Price declines in our common stock could result from general market and economic conditions and a variety of other factors, including:

- failure of our third-party collaborators (such as Pain Therapeutics or its commercialization sub-licensee King (now owned by Pfizer), Hospira, Nycomed, Alpharma (acquired by King which in turn is now owned by Pfizer) and Orient Pharma) to successfully develop and commercialize the respective pharmaceutical systems they are developing;

- adverse results (including adverse events or failure to demonstrate safety or efficacy) or delays in our clinical and non-clinical trials of POSIDUR, TRANSDUR-Sufentanil, ELADUR, Remoxy, our other ORADUR-based drug candidates or other pharmaceutical systems;

- announcements of FDA non-approval of our pharmaceutical systems, or delays in the FDA or other foreign regulatory agency review process;

- adverse actions taken by regulatory agencies or law enforcement agencies with respect to our pharmaceutical systems, clinical trials, manufacturing processes or sales and marketing activities, or those of our third party collaborators;

- announcements of technological innovations, patents or new products by our competitors;

- regulatory developments in the United States and foreign countries;

- any lawsuit involving us or our pharmaceutical systems including intellectual property infringement or product liability suits;

- announcements concerning our competitors, or the biotechnology or pharmaceutical industries in general;

- developments concerning our strategic alliances or acquisitions;

- actual or anticipated variations in our operating results;

changes in recommendations by securities analysts or lack of analyst coverage;

deviations in our operating results from the estimates of analysts;

sales of our common stock by our executive officers or directors or sales of substantial amounts of common stock by others;

changes in accounting principles; or

loss of any of our key scientific or management personnel.

The market price of our common stock may fluctuate significantly in response to factors which are beyond our control. The stock market in general has recently experienced extreme price and volume fluctuations. In addition, the market prices of securities of technology and pharmaceutical companies have also been extremely

Table of Contents

volatile, and have experienced fluctuations that often have been unrelated or disproportionate to the operating performance of these companies. These broad market fluctuations could result in extreme fluctuations in the price of our common stock, which could cause a decline in the value of our common stock.

In the past, following periods of volatility in the market price of a particular company s securities, litigation has often been brought against that company. If litigation of this type is brought against us, it could be extremely expensive and divert management s attention and our company s resources.

We have broad discretion over the use of our cash and investments, and their investment may not always yield a favorable return

Our management has broad discretion over how our cash and investments are used and may from time to time invest in ways with which our stockholders may not agree and that do not yield favorable returns.

Executive officers, directors and principal stockholders have substantial control over us, which could delay or prevent a change in our corporate control favored by our other stockholders

Our directors, executive officers and principal stockholders, together with their affiliates, have substantial control over us. The interests of these stockholders may differ from the interests of other stockholders. As a result, these stockholders, if acting together, would have the ability to exercise control over all corporate actions requiring stockholder approval irrespective of how our other stockholders may vote, including:

- the election of directors;
- the amendment of charter documents;
- the approval of certain mergers and other significant corporate transactions, including a sale of substantially all of our assets; or
- the defeat of any non-negotiated takeover attempt that might otherwise benefit the public stockholders.

Our certificate of incorporation, our bylaws, Delaware law and our stockholder rights plan contain provisions that could discourage another company from acquiring us.

Provisions of Delaware law, our certificate of incorporation, bylaws and stockholder rights plan may discourage, delay or prevent a merger or acquisition that stockholders may consider favorable, including transactions in which you might otherwise receive a premium for your shares. These provisions include:

- authorizing the issuance of blank check preferred stock without any need for action by stockholders;
- providing for a dividend on our common stock, commonly referred to as a poison pill, which can be triggered after a person or group acquires 17.5% or more of common stock;
- providing for a classified board of directors with staggered terms;

requiring supermajority stockholder voting to effect certain amendments to our certificate of incorporation and bylaws;

eliminating the ability of stockholders to call special meetings of stockholders;

prohibiting stockholder action by written consent; and

establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings.

Table of Contents

Item 1B. Unresolved Staff Comments.
None.

Item 2. Properties.
The following chart indicates the facilities that we lease, the location and size of each such facility and their designated use.

Location	Approximate Square Feet	Operation	Expiration
Cupertino, CA	30,000 sq. ft.	Office, Laboratory and Manufacturing	Lease expires 2014
Cupertino, CA	20,000 sq. ft.	Office and Laboratory	Lease expires 2014 (with an option to renew for an additional five years)
Cupertino, CA	40,560 sq. ft.	Office	Lease expires 2012 (with an option to renew for an additional six years)
Vacaville, CA	24,634 sq. ft.	Manufacturing	Lease expires 2013 (with an option to renew for an additional five years)
Pelham, AL	9,400 sq. ft.	Office, Laboratory and Manufacturing	Lease expires September 2011 (with an option to renew for an additional five years)
Birmingham, AL	21,540 sq. ft.	Office, Laboratory and Manufacturing	Lease expires 2021 (with an option to terminate after seven years and nine months and with two options to renew the lease term for an additional five years each after the current lease expires)

We believe that our existing facilities are adequate to meet our current and foreseeable requirements or that suitable additional or substitute space will be available as needed.

Item 3. Legal Proceedings.
We are not a party to any material legal proceedings.

Item 4. Reserved.

Table of Contents

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matter and Issuer Purchases of Equity Securities.

Price Range of Common Stock

Our common stock has been traded on the NASDAQ Global Market under the symbol DRRX since our initial public offering on September 28, 2000. The following table sets forth, for the periods indicated, the high and low sales prices for our common stock as reported by the NASDAQ Global Market.

	Common Stock Price	
Year ended December 31, 2009	**Low**	**High**
First Quarter	$ 1.40	$ 3.39
Second Quarter	2.01	2.86
Third Quarter	2.23	2.95
Fourth Quarter	2.04	2.69

Year ended December 31, 2010	**Low**	**High**
First Quarter	$ 1.91	$ 3.09
Second Quarter	2.23	3.14
Third Quarter	2.00	2.58
Fourth Quarter	2.48	3.69

The closing sale price of our common stock as reported on the NASDAQ Global Market on February 28, 2011 was $3.24 per share. As of that date there were approximately 136 holders of record of the common stock. This does not include the number of persons whose stock is in nominee or street name accounts through brokers. The market price of our common stock has been and may continue to be subject to wide fluctuations in response to a number of events and factors, such as progress in our development programs, quarterly variations in our operating results, announcements of technological innovations or new products by us or our competitors, changes in financial estimates and recommendations by securities analysts, the operating and stock performance of other companies that investors may deem comparable to us, and news reports relating to trends in our markets. These fluctuations, as well as general economic and market conditions, may adversely affect the market price for our common stock.

Dividend Policy

We have never paid cash dividends on our common stock. We currently intend to retain any future earnings to fund the development and growth of our business. Therefore, we do not currently anticipate paying any cash dividends in the foreseeable future.

Table of Contents

STOCK PERFORMANCE GRAPH

The following graph compares the cumulative total stockholder return data for our stock with the cumulative return of (i) The NASDAQ Stock Market (U.S.) Index and (ii) the NASDAQ Biotechnology Index since December 31, 2005. The graph assumes that $100 was invested on December 31, 2005. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

* $100 Invested on 12/31/05 in stock or index including reinvestment of dividends. Fiscal year ending December 31.

DURECT CORPORATION

	Cumulative Total Return					
	12/31/05	**12/31/06**	**12/31/07**	**12/31/08**	**12/31/09**	**12/31/10**
DURECT CORPORATION	100.00	87.57	126.82	66.86	48.72	68.05
NASDAQ STOCK MARKET (U.S.)	100.00	109.52	120.27	71.51	102.89	120.29
NASDAQ BIOTECHNOLOGY	100.00	101.02	105.65	92.31	106.74	122.76

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

None.

Table of Contents

Item 6. Selected Financial Data.

The following selected financial data should be read in conjunction with and are qualified by reference to Management s Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and related notes, which are included in this Form 10-K. The statement of operations data for the years ended December 31, 2010, 2009 and 2008 and the balance sheet data at December 31, 2010 and 2009 are derived from, and are qualified by reference to, the audited financial statements included elsewhere in this Form 10-K. The statement of operations data for the years ended December 31, 2007 and 2006, and the balance sheet data at December 31, 2008, 2007 and 2006 are derived from our audited statements not included in this Form 10-K. Historical operating results are not necessarily indicative of results in the future. See Note 1 of notes to financial statements for an explanation of the determination of the shares used in computing net loss per share.

	Year Ended December 31,				
	2010	2009	2008	2007	2006
	(in thousands, except per share data)				
Statement of Operations Data:					
Collaborative research and development and other revenue	$ 20,091	$ 12,347	$ 19,770	$ 27,379	$ 14,213
Product revenue, net	11,500	12,113	8,765	8,258	8,108
Total revenue	31,591	24,460	28,535	35,673	22,321
Operating expenses:					
Cost of revenue	4,275	5,311	3,365	3,225	3,248
Research and development	36,214	34,801	40,845	43,304	37,668
Selling, general and administrative	14,937	15,020	15,510	13,649	12,841
Write-down of deferred royalties and commercial rights			13,480		
Total operating expenses	55,426	55,132	73,200	60,178	53,757
Loss from operations	(23,835)	(30,672)	(44,665)	(24,541)	(31,436)
Other income (expense):					
Interest and other income	943	420	1,547	3,545	3,832
Interest expense	(6)	(36)	(789)	(2,625)	(3,436)
Debt conversion expense				(718)	(2,287)
Net other income (expense)	937	384	758	202	(1,891)
Net loss	$ (22,898)	$ (30,288)	$ (43,907)	$ (24,339)	$ (33,327)
Basic and diluted net loss per share	$ (0.26)	$ (0.36)	$ (0.56)	$ (0.35)	$ (0.51)
Shares used in computing basic and diluted net loss per share	86,868	83,427	78,332	70,483	65,961

	As of December 31,				
	2010	2009	2008	2007	2006
	(in thousands)				
Balance Sheet Data:					
Cash, cash equivalents and investments	$ 49,572	$ 41,552	$ 52,692	$ 62,016	$ 81,607
Working capital	36,936	34,796	43,401	25,700	63,100
Total assets	67,560	58,151	74,874	84,020	102,485
Convertible subordinated notes				23,559	37,337
Other long-term liabilities	315	508	656	1,083	910
Stockholders equity	14,487	27,843	37,564	34,581	37,032

Table of Contents

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

This Management s Discussion and Analysis of Financial Condition and Results of Operations as of December 31, 2010, 2009 and 2008 should be read in conjunction with our Financial Statements, including the Notes thereto, and Risk Factors section included elsewhere in this Form 10-K. This Form 10-K contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. When used in this report or elsewhere by management from time to time, the words believe, anticipate, intend, plan, estimate, expect and similar expressions are forward-looking statements. Such forward-looking statements contained herein are based on current expectations.

Forward-looking statements made in this report include, for example, statements about:

potential regulatory approval of Remoxy or any of our other product candidates;

the progress of our third-party collaborations, including estimated milestones;

our intention to seek, and ability to enter into strategic alliances and collaborations;

the potential benefits and uses of our products;

responsibilities of our collaborators, including the responsibility to make cost reimbursement, milestone, royalty and other payments to us, and our expectations regarding our collaborators plans with respect to our products;

our responsibilities to our collaborators, including our responsibilities to conduct research and development, clinical trials, protect intellectual property and manufacture products;

market opportunities for products in our product pipeline;

the number of patients enrolled and the timing of patient enrollment in clinical trials;

the progress and results of our research and development programs;

requirements for us to purchase supplies and raw materials from third parties, and the ability of third parties to provide us with required supplies and raw materials;

the results and timing of clinical trials and the commencement of future clinical trials;

conditions for obtaining regulatory approval of our product candidates;

submission and timing of applications for regulatory approval;

the impact of FDA, DEA, EMEA and other government regulation on our business;

the impact of potential Risk Evaluation and Mitigation Strategies on our business;

uncertainties associated with obtaining and protecting patents and other intellectual property rights, as well as avoiding the intellectual property rights of others;

products and companies that will compete with the products we license to third-party collaborators;

the possibility we may commercialize our own products and build up our commercial, sales and marketing capabilities and other required infrastructure;

our intention to develop additional manufacturing capabilities and our expectations regarding the number of employees involved in manufacturing;

our employees, including the number of employees and the continued services of key management, technical and scientific personnel;

our future performance, including our anticipation that we will not derive meaningful revenues from our pharmaceutical systems for at least twelve months and our expectations regarding our ability to achieve profitability;

Table of Contents

sufficiency of our cash resources, anticipated capital requirements and capital expenditures and our need for additional financing;

our ability to utilize our equity line of credit facility with Azimuth Opportunity Ltd.;

our expectations regarding marketing expenses, research and development expenses, and selling, general and administrative expenses;

the composition of future revenues; and

accounting policies and estimates, including revenue recognition policies.

Forward-looking statements are not guarantees of future performance and involve risks and uncertainties. Actual events or results may differ materially from those discussed in the forward-looking statements as a result of various factors. For a more detailed discussion of such forward looking statements and the potential risks and uncertainties that may impact upon their accuracy, see the Risk Factors section and Overview section of this Management s Discussion and Analysis of Financial Condition and Results of Operations. These forward-looking statements reflect our view only as of the date of this report. We undertake no obligations to update any forward-looking statements. You should also carefully consider the factors set forth in other reports or documents that we file from time to time with the Securities and Exchange Commission.

Overview

We are a specialty pharmaceutical company focused on the development of pharmaceutical products based on our proprietary drug delivery technology platforms. Our product pipeline currently consists of seven investigational drug candidates in clinical development, with one program the subject of a New Drug Application (NDA) with the U.S. Food and Drug Administration (FDA), one program in Phase III, two programs in Phase II and three programs in Phase I. The more advanced programs are all in the field of pain management and we believe that each of these targets large market opportunities with product features that are differentiated from existing therapeutics. We have other programs underway in fields outside of pain management, including several efforts underway which seek to improve the administration of biotechnology agents such as proteins and peptides.

A central aspect of our business strategy involves advancing multiple product candidates at one time, which is enabled by leveraging our resources with those of corporate collaborators. Thus, certain of our programs are currently licensed to corporate collaborators on terms which typically call for our collaborator to fund all or a substantial portion of future development costs and then pay us milestone payments based on specific development or commercial achievements plus a royalty on product sales. At the same time, we have retained the rights to other programs, which are the basis of future collaborations and over time may provide a pathway for us to develop our own commercial, sales and marketing organization.

Collaborative Research and Development Revenues

Collaborative research and development revenues consist of three broad categories: (a) the recognition of upfront license payments on a straight-line basis over the period of our continuing involvement with the third party, (b) the reimbursement of qualified research expenses by third parties and (c) milestone payments in connection with our collaborative agreements. During the last several years, we generated collaborative research and development revenues from collaborative agreements with Pain Therapeutics, Nycomed, King, Hospira, Endo and others.

Product Revenues

We have historically generated product revenue from the sale of three product lines:

ALZET® osmotic pumps for animal research use;

53

Table of Contents

LACTEL® biodegradable polymers which are used by our customers as raw materials in their pharmaceutical and medical products; and

certain key excipients that are included in Remoxy.

In the future, we expect to generate modest revenue related to an animal health product which was approved and launched by our licensee in 2011. Because we consider our core business to be developing and commercializing pharmaceutical systems, we do not intend to significantly increase our investments in or efforts to sell or market any of our existing product lines. However, we expect that we will continue to make efforts to increase our revenue related to collaborative research and development by entering into additional research and development agreements with third-party collaborators to develop product candidates based on our drug delivery technologies.

Reduction In Force

In March 2009, we reduced the size of our California workforce by 41 employees or approximately 24% of our headcount. The goal of this action was to better align our cost structure with anticipated revenues and operating expenses, while not compromising our key corporate objectives for the year. We substantially completed this headcount reduction during the first quarter of 2009, and incurred approximately $443,000 in severance costs for the impacted employees in 2009.

Operating Results

Since our inception in 1998, we have had a history of operating losses. At December 31, 2010, we had an accumulated deficit of $336.8 million and our net losses were $22.9 million, $30.3 million and $43.9 million for the years ended December 31, 2010, 2009 and 2008, respectively. These losses have resulted primarily from costs incurred to research and develop our product candidates and to a lesser extent, from selling, general and administrative costs associated with our operations and product sales. We expect our research and development expenses to increase modestly in the near future as we expect to continue to expand our clinical trials, nonclinical studies and other research and development activities. We expect selling, general and administrative expenses to remain comparable in the near future. We do not anticipate meaningful revenues from our pharmaceutical systems, should they be approved, for at least the next twelve months. Therefore, we expect to incur continuing losses and negative cash flow from operations for the foreseeable future.

Critical Accounting Policies and Estimates

General

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. The most significant estimates and assumptions relate to revenue recognition, the recoverability of our long-lived assets, including goodwill and other intangible assets, accrued liabilities, contract research liabilities, inventories and stock-based compensation. Actual amounts could differ significantly from these estimates.

Revenue Recognition

Revenue from the sale of products is recognized when there is persuasive evidence that an arrangement exists, the product is shipped and title transfers to customers, provided no continuing obligation on our part exists, the price is fixed or determinable and the collectability of the amounts owed is reasonably assured. We enter into license and collaboration agreements under which we may receive upfront license fees, research funding and contingent milestone payments and royalties. The accounting standards contain a presumption that separate contracts entered into at or near the same time with the same entity or related parties were negotiated as

Table of Contents

a package and should be evaluated as a single agreement. Our deliverables under these arrangements typically consist of intellectual property rights and research and development services. We evaluate whether there is stand-alone value for the delivered elements and objective and reliable evidence of fair value for the undelivered element(s) to allocate revenue to each element in multiple element agreements. When the delivered element does not have stand-alone value or there is insufficient evidence of fair value for the undelivered element(s), we recognize the consideration for the combined unit of accounting in the same manner as the revenue is recognized for the final deliverable, which is generally ratably over the longest period of involvement. Returns or credits related to the sale of products have not had a material impact on our revenues or net loss.

Upfront payments received upon execution of collaborative agreements are recorded as deferred revenue and recognized as collaborative research and development revenue based on a straight-line basis over the period of our continuing involvement with the third party collaborator pursuant to the applicable agreement. Such period generally represents the longer of the expected research and development period or other continuing obligation period defined in the respective agreements between us and our third-party collaborators.

Research and development revenue related to services performed under the collaborative arrangements with our corporate collaborators is recognized as the related research and development services are performed and the collectability of the amounts owed is reasonably assured. These research payments received under each respective agreement are not refundable and are generally based on reimbursement of qualified expenses, as defined in the agreements. Research and development expenses under the collaborative research and development agreements generally approximate or exceed the revenue recognized under such agreements over the term of the respective agreements. Deferred revenue may result when we do not expend the required level of effort during a specific period in comparison to funds received under the respective agreement. Pursuant to ASC 808-10, *Collaborative Arrangements*, for joint control and funding development activities, we recognize revenue from the net reimbursement of the research and development expenses from our partners and record the net payment of research and development expenses to our partners as additional research and development expense.

Milestone payments under collaborative arrangements are recognized as revenue upon achievement of the at risk milestone events, which represent the culmination of the earnings process related to that milestone. Milestone payments are triggered either by the results of our research and development efforts or by events external to us, such as regulatory approval to market a product or the achievement of specified sales levels by a third-party collaborator. As such, the milestones are substantially at risk at the inception of the collaboration agreement, and the amounts of the payments assigned thereto are commensurate with the milestone achieved. In addition, upon the achievement of a milestone event, we have no future performance obligations related to that milestone payment.

Research and Development Expenses

Research and development expenses are primarily comprised of salaries, benefits, stock-based compensation and other compensation cost associated with research and development personnel, overhead and facility costs, preclinical and non-clinical development costs, clinical trial and related clinical manufacturing costs, contract services, and other outside costs. Research and development costs are expensed as incurred. Research and development costs paid to third parties under sponsored research agreements are recognized as expense as the related services are performed, generally ratably over the period of service. In addition, net reimbursements of research and development expenses by our partners incurred are recorded as collaborative research and development revenue. Net payments of research and development expenses to our partners are recorded as an addition to our research and development expenses in the period incurred.

Goodwill

We record intangible assets when we acquire other companies and intellectual property rights. The cost of an acquisition is allocated to the assets acquired and liabilities assumed, including intangible assets, with the remaining amount being classified as goodwill.

Table of Contents

Goodwill is periodically assessed for impairment. We assess the impairment of goodwill at least annually and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include the following:

- significant decline in our stock price for a sustained period;
- our market capitalization relative to net book value;
- new information affecting the commercial value of the asset;
- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business; and
- significant negative industry or economic trends.

If we determine that the carrying value of our goodwill may not be recoverable based upon the existence of one or more of the above indicators of impairment, we measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model. We would also reconcile our estimate of total enterprise value to our market capitalization. As of December 31, 2010, the carrying value of goodwill was approximately $6.4 million. No impairment of goodwill has been recorded through December 31, 2010. However, there can be no assurance that at the time other periodic reviews are completed, a material impairment charge will not be recorded.

Accrued Liabilities and Contract Research Liabilities

We incur significant costs associated with third party consultants and organizations for pre-clinical studies, clinical trials, contract manufacturing, validation, testing, and other research and development-related services. We are required to estimate periodically the cost of services rendered but unbilled based on management s estimates of project status. If these good faith estimates are inaccurate, actual expenses incurred could materially differ from our estimates.

Inventories

Inventories include certain excipients that are sold to a customer and included in products awaiting regulatory approval. These inventories are capitalized based on management s judgment of probable sale prior to their expiration date which in turn is based on non-binding forecasts from our customer. The valuation of inventory requires us to estimate the value of inventory that may become expired prior to use. We may be required to expense previously capitalized inventory costs upon a change in our judgment, due to, among other potential factors, a denial or delay of approval of our customer s product by the necessary regulatory bodies, or new information that suggests that the inventory will not be saleable. In addition, these circumstances may cause us to record a liability related to minimum purchase agreements that we have in place for raw materials.

Stock-Based Compensation

Employee stock-based compensation is estimated at the date of grant based on the employee stock award s fair value using the Black-Scholes option-pricing model and is recognized as expense ratably over the requisite period in a manner similar to other forms of compensation paid to employees.

We estimate the volatility of our common stock at the date of grant based on the historical volatility of our common stock. We base the risk-free rate that we use in the Black-Scholes option valuation model on the implied yield in effect at the time of option grant on U.S. Treasury

zero-coupon issues with equivalent remaining terms. We have never paid any cash dividends on our common stock and we do not anticipate paying any cash dividends in the foreseeable future. Consequently, we use an expected dividend yield of zero in the Black-Scholes option valuation model. We estimate forfeitures at the time of grant and revise those estimates in

Table of Contents

subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. For options granted before January 1, 2006, we amortize the fair value on an accelerated basis. For options granted on or after January 1, 2006, we amortize the fair value on a straight-line basis. All options are amortized over the requisite service periods of the awards, which are generally the vesting periods. We may elect to use different assumptions under the Black-Scholes option valuation model in the future, which could materially affect our net income or loss and net income or loss per share.

Recent Accounting Pronouncements

In October 2009, the FASB issued ASU No. 2009-13, Revenue Recognition *Multiple Deliverable Revenue Arrangements* (ASU 2009-13). ASU 2009-13 provides application guidance on whether multiple deliverables exist, how the deliverables should be separated and how the consideration should be allocated to one or more units of accounting. This update establishes a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence, if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific or third-party evidence is available. We have adopted this guidance prospectively beginning on January 1, 2011. Under ASU 2009-13, we may be required to exercise considerable judgment in determining the estimated selling price of delivered items under new agreements and our revenue under new agreements may be more accelerated as compared to the prior accounting standard. As such, the adoption of ASU 2009-13 could have a material impact on our financial statements going forward.

Results of Operations

Comparison of years ended December 31, 2010, 2009 and 2008

Collaborative research and development and other revenue

We recognize revenues from collaborative research and development activities and service contracts. Collaborative research and development revenue primarily represents net reimbursement of qualified expenses related to the collaborative agreements with various third parties to research, develop and commercialize potential products using our drug delivery technologies, revenue recognized from ratable recognition of upfront fees and milestone payments in connection with our collaborative agreements.

We expect our collaborative research and development revenue to fluctuate in future periods pending our efforts to enter into potential new collaborations and our existing third party collaborators commitment to and progress in the research and development programs. The collaborative research and development and other revenues associated with our major collaborators are as follows (in thousands):

	Year ended December 31,		
	2010	2009	2008
Collaborator			
King Pharmaceuticals, Inc. (King)(1)	$ 9,487	$ 7,024	$ 3,412
Hospira Inc. (Hospira)(2)	5,551		
Nycomed Danmark ApS (Nycomed)(3)	2,033	1,620	4,485
Pain Therapeutics, Inc. (Pain Therapeutics)(4)	1,456	317	6,410
Endo Pharmaceuticals, Inc. (Endo)(5)		985	3,934
Others	1,564	2,401	1,529
Total collaborative research and development and other revenue	$ 20,091	$ 12,347	$ 19,770

(1) Amounts related to ratable recognition of upfront fees were $3.2 million in 2010, $3.4 million in 2009 and $752,000 in 2008.

(2) Amounts related to ratable recognition of upfront fees were $2.1 million in 2010 and zero in 2009 and 2008.

57

Table of Contents

(3) Amounts related to ratable recognition of upfront fees were $1.2 million in 2010, $1.5 million in 2009 and $3.1 million in 2008.

(4) Amounts related to milestone revenue recognized in connection with the Pain Therapeutics collaboration were zero in both 2010 and 2009 and $850,000 in 2008.

(5) Amounts related to ratable recognition of upfront fees were zero in 2010, $875,000 in 2009 and $3.0 million in 2008. Our agreement with Endo terminated effective August 26, 2009.

We recorded $20.1 million of collaborative research and development and other revenue in 2010 compared to $12.3 million in 2009. The increase in collaborative research and development revenue in 2010 compared to 2009 was primarily attributable to higher revenue recognized in connection with our agreements with Hospira, King, Pain Therapeutics and Nycomed, partially offset by no revenue from Endo and lower revenue from feasibility projects.

We recorded $12.3 million of collaborative research and development and other revenue in 2009 compared to $19.8 million in 2008. The decrease in collaborative research and development revenue in 2009 was primarily attributable to lower revenue recognized in connection with our agreements with Pain Therapeutics, Endo and Nycomed, partially offset by higher collaborative research and development revenue recognized in connection with our agreements with King and various feasibility agreements compared to 2008.

We received a $27.5 million upfront fee in connection with the development and license agreement signed with Hospira in June 2010 relating to POSIDUR. The $27.5 million upfront fee is recognized as collaborative research and development revenue ratably over the term of our continuing involvement with Hospira with respect to POSIDUR.

We also received a $20.0 million upfront fee in connection with the development and license agreement signed with Alpharma (acquired by King which was subsequently acquired by Pfizer) in September 2008 relating to ELADUR. The $20.0 million upfront fee is recognized as collaborative research and development revenue ratably over the term of our continuing involvement with Alpharma with respect to ELADUR. Our estimate of the remaining term of our continuing involvement was modified in the second quarter of 2009 as a result of an updated development plan for ELADUR.

We also received a $14.0 million upfront fee in connection with the development and license agreement signed with Nycomed in November 2006 relating to POSIDUR. The $14.0 million upfront fee is recognized as collaborative research and development revenue ratably over the term of our continuing involvement with Nycomed with respect to POSIDUR. Our estimate of the remaining term of our continuing involvement was modified in the first quarter and the fourth quarter of 2009 as a result of updated development plans for POSIDUR in Europe.

We also received a $10.0 million upfront fee in connection with the license agreement signed with Endo in March 2005 relating to TRANSDUR-Sufentanil. The $10.0 million upfront fee is recognized as collaborative research and development revenue ratably over the term of our continuing involvement with Endo with respect to TRANSDUR-Sufentanil. The term of the continuing involvement had been estimated based on the product development plan pursuant to the agreement. Our estimate of the remaining term of our continuing involvement was modified in the fourth quarter of 2008 as a result of Endo s termination notice that we received in February 2009. The $10.0 million upfront fee from Endo was fully recognized as of March 31, 2009.

Product revenue

A portion of our revenues is derived from our product sales, which include our ALZET mini pump product line, our LACTEL biodegradable polymer product line and certain excipients that are included in Remoxy. Net product revenues were $11.5 million, $12.1 million and $8.8 million in 2010, 2009 and 2008, respectively.

Table of Contents

The decrease in product revenue in 2010 was primarily attributable to lower product revenue from the sale of certain excipients included in Remoxy to King as discussed below, partially offset by higher product revenue from both the LACTEL and ALZET product lines compared to 2009. Product revenue in 2009 included $3.0 million related to shipments to King that occurred in 2008 and the first quarter of 2009 but that had been deferred until a long term supply agreement was signed such that final terms and conditions of the sales were established. This agreement was executed in the quarter ended September 30, 2009, and all of the deferred revenue was recognized as revenue in that period. In 2010, we experienced higher product revenue from our ALZET product line as well as from the LACTEL product line primarily as a result of ALZET s higher average realized prices and higher LACTEL unit sales compared with 2009.

The increase in product revenue in 2009 compared with 2008 was primarily attributable to higher product revenue from the sale of certain excipients included in Remoxy to King. In addition, we experienced higher product revenue from our LACTEL product line as a result of higher units sold, partially offset by lower revenue from our ALZET product line as a result of lower units sold in 2009.

Cost of revenues. Cost of revenues was $4.3 million, $5.3 million and $3.4 million in 2010, 2009 and 2008, respectively. Cost of revenues include the cost of product revenue from our ALZET product line, our LACTEL product line and certain excipients that are included in Remoxy. The decrease in the cost of product revenue in 2010 was primarily the result of lower product revenue associated with certain excipients for Remoxy, partially offset by higher units sold from our LACTEL product line compared to 2009. Cost of product revenue and gross profit margin will fluctuate from period to period depending upon the product mix in a particular period.

The increase in the cost of product revenue in 2009 compared to 2008 was primarily the result of recognizing $2.0 million of cost of certain excipients for Remoxy sold to King, partially offset by lower units sold from our ALZET product line and improved manufacturing efficiency from our LACTEL polymer product line. Cost of goods sold aggregating $562,000 in 2008 had been deferred until the execution of a final supply agreement with King in the third quarter of 2009.

Stock-based compensation expense recognized related to cost of revenues was $341,000, $433,000 and $135,000 in 2010, 2009 and 2008, respectively.

As of December 31, 2010, 2009 and 2008, we had 25, 22 and 31 manufacturing employees, respectively. We expect the number of employees involved in manufacturing will remain comparable in the near future.

Research and Development. Research and development expenses are primarily comprised of salaries, benefits, stock-based compensation and other compensation cost associated with research and development personnel, overhead and facility costs, preclinical and non-clinical development costs, clinical trial and related clinical manufacturing costs, contract services, and other outside costs. Research and development expenses were $36.2 million, $34.8 million and $40.8 million in 2010, 2009 and 2008. Stock-based compensation expense recognized related to research and development personnel was $4.9 million, $7.2 million and $5.6 million in 2010, 2009 and 2008, respectively.

Research and development expenses increased by $1.4 million in 2010 compared to 2009. The increase in 2010 was primarily attributable to higher development costs associated with POSIDUR, Remoxy and other ORADUR-based opioid products licensed to Pain Therapeutics and our biologics programs, partially offset by lower development costs associated with ELADUR, ORADUR-ADHD, TRANSDUR-Sufentanil and other research programs compared to 2009 as more fully discussed below.

Research and development expenses decreased by $6.0 million in 2009 compared to 2008. The decrease in 2009 was primarily attributable to lower development costs associated with ELADUR, Remoxy and other select ORADUR-based opioid drug candidates and our biologics programs, partially offset by higher development costs associated with POSIDUR, our ORADUR-ADHD program and our other research programs compared to 2008

Table of Contents

as more fully discussed below. In addition, we paid $2.25 million to EpiCept in the third quarter of 2008 under our amended agreement with EpiCept and recorded this amount as a research and development expense attributed to ELADUR in 2008.

Research and development expenses associated with our major development programs approximate the following (in thousands):

	Year Ended December 31,		
	2010	2009	2008
POSIDUR(1)	$ 16,017	$ 14,250	$ 9,515
Remoxy and other ORADUR-based opioid products (1)	3,710	1,688	5,274
ELADUR(1)	3,420	3,823	11,852
Biologics Programs	1,675	1,638	4,614
ORADUR-ADHD	1,382	2,155	1,091
TRANSDUR-Sufentanil (1)	871	1,387	1,365
Others	9,139	9,860	7,134
Total research and development expenses	$ 36,214	$ 34,801	$ 40,845

(1) See Note 2 Strategic Agreements in the financial statements for more details about our agreements with Hospira, Nycomed, King, Pain Therapeutics and Endo.

POSIDUR

Our research and development expenses for POSIDUR increased to $16.0 million in 2010 from $14.3 million in 2009, primarily due to higher costs associated with our Phase III clinical trial and higher employee costs for POSIDUR compared to 2009.

Our research and development expenses for POSIDUR increased to $14.3 million in 2009 from $9.5 million in 2008, primarily due to higher costs associated with Phase II clinical trials conducted by Nycomed and us in 2009 compared to 2008.

Remoxy and other ORADUR-based opioid products

Our research and development expenses for Remoxy and other ORADUR-based opioids increased to $3.7 million in 2010 from $1.7 million in 2009, primarily due to increased activities to support the resubmission of the Remoxy NDA in 2010.

Our research and development expenses for Remoxy and other ORADUR-based opioids decreased to $1.7 million in 2009 from $5.3 million in 2008, primarily due to decreased support activities for Remoxy after the filing of the Remoxy NDA which occurred in 2008 as well as decreased formulation and clinical manufacturing activities for other select ORADUR-based opioid drug candidates in 2009.

ELADUR

Our research and development expenses for ELADUR decreased to $3.4 million in 2010 from $3.8 million in 2009, primarily due to lower employee costs and lower contract manufacturing expenses related to this product candidate.

Our research and development expenses for ELADUR decreased to $3.8 million in 2009 from $11.9 million in 2008, primarily due to lower employee costs, non-clinical studies and contract manufacturing expenses related to this product candidate. In addition, we paid $2.25 million to EpiCept in 2008 related to certain intellectual property relevant to ELADUR under our amended agreement with EpiCept and recorded this amount as a R&D expense in 2008.

Table of Contents

Biologics Programs

Our research and development expenses for biologics programs increased to $1.7 million in 2010 from $1.6 million in 2009. primarily due to higher external costs and employee related costs in support of these programs in 2010.

Our research and development expenses for biologics programs decreased to $1.6 million in 2009 from $4.6 million in 2008, primarily due to lower external costs and employee related costs in support of these programs in 2009.

ORADUR-ADHD

Our research and development expenses for ORADUR-ADHD decreased to $1.4 million in 2010 from $2.2 million in 2009, primarily due to lower employee costs incurred for this program in 2010.

Our research and development expenses for ORADUR-ADHD increased to $2.2 million in 2009 from $1.1 million in 2008, primarily due to increased formulation and other development activities for this program in 2009.

TRANSDUR-Sufentanil

Our research and development expenses for TRANSDUR-Sufentanil decreased to $871,000 in 2010 from $1.4 million in 2009, primarily due to decreased external and employee costs for this drug candidate in 2010.

Our research and development expenses for TRANSDUR-Sufentanil were $1.4 million in both 2009 and 2008. We incurred higher employee related cost for this product candidate in 2009 than in 2008, essentially offset by decreased external costs.

Other DURECT Research Programs

Our research and development expenses for all other activities decreased to $9.1 million in 2010 from $9.9 million in 2009, primarily due to lower employee related costs and decreased formulation and development activities for these programs.

Our research and development expenses for all other activities increased to $9.9 million from $7.1 million in 2008, primarily due to higher employee related costs and increased formulation and development activities for these programs.

As of December 31, 2010, 2009 and 2008, we had 76, 77 and 104 research and development employees respectively. We expect research and development expenses to increase modestly in the near future as we continue product development efforts for our internal and partnered product candidates.

We cannot reasonably estimate the timing and costs of our research and development programs due to the risks and uncertainties associated with developing pharmaceutical systems as outlined in the Risk Factors section of this report. The duration of development of our research and development programs may span as many as ten years or more, and estimation of completion dates or costs to complete would be highly speculative and subjective due to the numerous risks and uncertainties associated with developing pharmaceutical products, including significant and changing government regulation, the uncertainties of future preclinical and clinical study results, the uncertainties with our collaborators commitment to and progress in the programs and the uncertainties associated with process development and manufacturing as well as sales and marketing. In addition, with respect to our development programs subject to third-party collaborations, the timing and expenditures to complete the programs are subject to the control of our collaborators. Therefore, we cannot reasonably estimate the timing and estimated costs of the efforts necessary to complete the research and development programs. For additional information regarding these risks and uncertainties, see Risk Factors above.

Table of Contents

Selling, General and Administrative. Selling, general and administrative expenses are primarily comprised of salaries, benefits and stock-based compensation associated with finance, legal, business development, sales and marketing and other administrative personnel, overhead and facility costs, and other general and administrative costs. Selling, general and administrative expenses were $14.9 million, $15.0 million and $15.5 million in 2010, 2009 and 2008, respectively. Stock-based compensation expense recognized related to selling, general and administrative personnel was $2.5 million, $3.8 million and $2.8 million in 2010, 2009 and 2008, respectively.

Selling, general and administrative expenses decreased by $83,000 in 2010 compared to 2009, primarily due to lower stock based compensation expenses related to selling, general and administrative personnel, offset by higher patent and market research expenses incurred in 2010 compared to 2009.

Selling, general and administrative expenses decreased by $490,000 in 2009 compared to 2008, primarily due to lower employee, patent and consulting expenses incurred in 2009 compared to 2008.

As of December 31, 2010, 2009 and 2008, we had 29, 28 and 38 selling, general and administrative personnel, respectively. We expect selling, general and administrative expenses to remain comparable in the near future.

Write-down of deferred royalties and commercial rights. Write-down of deferred royalties and commercial rights was $13.5 million in 2008. We had no similar charges in the other periods presented. In 2000, we recorded the fair value of common stock and a warrant that we issued to ALZA Corporation in connection with an amended agreement related to CHRONOGESIC. The amounts were recorded in stockholders equity as additional paid-in capital and as a contra-equity account referred to as deferred royalties and commercial rights. At the end of 2008, we made the strategic decision that other research and development programs would take priority over CHRONOGESIC and recorded a $13.5 million non-cash write-down of deferred royalties and commercial rights given the fact that there are no plans in the foreseeable future to actively attempt to develop CHRONOGESIC.

Other Income (Expense). Interest and other income was $943,000, $420,000 and $1.5 million in 2010, 2009 and 2008, respectively. The increase in interest and other income in 2010 as compared to 2009 was primarily due to the receipt of grants totaling $733,000 under the Patient Protection and Affordable Care Act of 2010 for three qualifying therapeutic discovery projects in the fourth quarter of 2010. The decrease in interest and other income in 2009 was primarily the result of lower yields on our investments as well as lower average cash and investment balances compared to 2008.

Interest expense was $6,000, $36,000 and $789,000 in 2010, 2009 and 2008, respectively. The decrease in interest expense in 2010 compared to 2009 was primarily due to a lower outstanding balance of equipment financing obligations in 2010. The decrease in interest expense in 2009 compared to 2008 was primarily due to the conversion of the remaining $23.6 million in aggregate principal amount of convertible notes in June 2008.

Income taxes. As of December 31, 2010, we had net operating loss (NOL) carryforwards for federal income tax purposes of approximately $232.5 million, which expire in the years 2018 through 2030, and federal research and development tax credits of approximately $4.7 million, which expire at various dates beginning in 2018 through 2030, if not utilized. As of December 31, 2010, we had NOL carryforwards for state income tax purpose of approximately $142.6 million, which expire in the years 2012 through 2030, and state research and development tax credits of approximately $5.1 million, which do not expire. Utilization of the net operating losses may be subject to a substantial annual limitation due to federal and state ownership change limitations. The annual limitation may result in the expiration of net operating losses and credits before utilization.

As of December 31, 2010 and 2009, we had net deferred tax assets of $115.9 million and $107.3 million, respectively. Deferred tax assets reflect the net tax effects of net operating loss and credit carryforwards and the

Table of Contents

temporary differences between the carrying amounts of assets and liabilities for financial reporting and the amounts used for income tax purposes. Realization of deferred tax assets is dependent upon future earnings, if any, the timing and amount of which are uncertain. Accordingly, the net deferred tax assets have been fully offset by a valuation allowance.

Because realization of such tax benefits is uncertain, we provided a 100% valuation allowance as of December 31, 2010 and December 31, 2009. Utilization of the NOL and R&D credits carryforwards may be subject to a substantial annual limitation due to ownership change limitations that have occurred previously or that could occur in the future provided by Sections 382 and 383 of the Internal Revenue Code of 1986, as well as similar state and foreign provisions. These ownership changes may limit the amount of NOL and R&D credits carryforwards that can be utilized annually to offset future taxable income and tax, respectively. In general, an ownership change, as defined by Section 382, results from transactions increasing the ownership of certain shareholders or public groups in the stock of a corporation by more than 50 percentage points over a three-year period. Since our formation, we have raised capital through the issuance of capital stock on several occasions which, combined with the purchasing shareholders subsequent disposition of those shares, may have resulted in a change of control, as defined by Section 382, or could result in a change of control in the future upon subsequent disposition. In addition, we issued $60.0 million of convertible notes in 2003 and subsequently all of these notes had been converted as of December 31, 2008 into our common stock. We also issued approximately 4.4 million shares of our common stock to Venrock in connection with an equity financing in September 2009. These transactions may also have resulted in a change of control or could result in a change of control in the future upon the subsequent disposition of the shares.

We have not currently completed a study to assess whether a change in control has occurred or whether there have been multiple changes of control since our formation due to the significant complexity and cost associated with such a study and the fact that there could be additional changes in the future. If we have experienced a change of control at any time since our formation, utilization of our NOL or R&D credits carryforwards would be subject to an annual limitation under Sections 382 and 383 which is determined by first multiplying the value of our stock at the time of the ownership change by the applicable long-term tax-exempt rate, and then could be subject to additional adjustments, as required. Any limitation may result in expiration of a portion of our NOL or R&D credits carryforwards before utilization. Tax years 1998 to 2010 remain subject to future examination by the major tax jurisdictions in which we are subject to tax.

Liquidity and Capital Resources

We had cash, cash equivalents, and investments totaling $49.6 million and $41.6 million at December 31, 2010 and 2009, respectively. This includes $933,000 and $431,000 of interest-bearing marketable securities classified as restricted investments on our balance sheet as of December 31, 2010 and 2009, respectively, which primarily serve as collateral for letters of credit securing our leased facilities in California and Alabama. The letters of credit related to the security deposit of the leased facilities will expire in December 2012 and July 2021.

We received $7.8 million of cash in operating activities in the year ended December 31, 2010 and used $20.9 million and $9.4 million of cash in operating activities in the years ended December 31, 2009 and 2008, respectively. The increase in cash provided by operations in 2010 was primarily attributable to the receipt of a $27.5 million upfront payment from Hospira in June 2010. The increase in cash used in operating activities in 2009 compared to 2008 was primarily due to a $20.0 million upfront payment received from Alpharma in 2008.

We used $6.1 million and $10.4 million of cash from investing activities in the years ended December 31, 2010 and 2009, respectively, but generated $289,000 of cash from investing activities in the year ended December 31, 2008. The decrease in cash used in investing activities in 2010 was primarily due to a decrease in net purchases of investments and in purchases of equipment compared with 2009. The increase in cash used in investing activities in 2009 was primarily due to higher net purchases of investments, partially offset by reduced purchases of property and equipment compared with 2008. We also anticipate incurring capital expenditures of

Table of Contents

approximately $1.5 million over the next 12 months. The majority of these expenditures in 2011 relate to our outfitting a newly leased facility in Alabama to support our LACTEL product line and polymer research activities. The actual amount and timing of other capital expenditures will depend, among other things, on the success of clinical trials for our product candidates and our collaborative research and development activities.

We generated $517,000, $10.1 million and $1.0 million of cash from financing activities in the years ended December 31, 2010, 2009 and 2008, respectively. The lower amount of cash provided by financing activities in 2010 compared to 2009 was primarily due to approximately $9.9 million of cash received from an equity financing in 2009. The increase in cash provided by financing activities in 2009 compared to 2008 was also due to the cash received from the equity financing in 2009. In November 2008, we filed a new shelf registration statement on Form S-3 with the SEC, which upon being declared effective in May 2009, allowed us to offer up to $75 million of securities from time to time in one or more public offerings of our common stock. In September 2009, we completed a privately negotiated transaction to sell 4,444,444 shares of our common stock to affiliates of Venrock at a price of $2.25 per share, raising total net proceeds of approximately $9.9 million.

In July 2010, we entered into an equity line of credit facility with Azimuth Opportunity Ltd., or Azimuth, under which we may sell to Azimuth, subject to certain limitations, up to $50 million of our common stock over a 24-month period. Azimuth will not be obligated to purchase shares under the equity line of credit unless specified conditions are met. If we are unable to meet the specified conditions with respect to any sale of shares under the Azimuth equity line of credit, we may be unable to access this source of financing. Azimuth is also permitted to terminate the equity line of credit under certain circumstances.

Cash used in our operating activities is heavily influenced by the timing and structure of new corporate collaborations. While one feature of our business strategy is seeking new corporate collaborations, assuming no new collaborations and no milestone payments, we anticipate that cash used in operating activities will increase in the near future as we continue to research, develop, and manufacture our pharmaceutical systems. In aggregate, we are required to make future payments pursuant to our existing contractual obligations as follows (in thousands):

Contractual Obligations	2011	2012	2013	2014	2015	2016 and thereafter	Total
Capital lease(1)	$ 12	$	$	$	$	$	$ 12
Purchase commitments	500	500	500	500	500	1,500	4,000
Operating lease obligations	2,253	2,362	1,559	454	286	1,734	8,648
Total contractual cash obligations	$ 2,765	$ 2,862	$ 2,059	$ 954	$ 786	$ 3,234	$ 12,660

(1) Includes principal and interest payments.

We believe that our existing cash, cash equivalents and investments will be sufficient to fund our planned operations, existing debt and contractual commitments and planned capital expenditures through at least the next 12 months. We may consume available resources more rapidly than currently anticipated, resulting in the need for additional funding. Additionally, we do not expect to generate significant revenues from our pharmaceutical systems currently under development for at least the next twelve months, if at all. Depending on whether we enter into additional collaborative agreements in the near term and the extent to which we earn milestone revenues, we may be required to raise additional capital through a variety of sources, including:

- the public equity markets;
- private equity financings;
- collaborative arrangements; and/or

public or private debt.

Table of Contents

There can be no assurance that we will enter into additional collaborative agreements in the near term, will earn milestone revenues or additional capital will be available on favorable terms, if at all. If adequate funds are not available, we may be required to significantly reduce or refocus our operations or to obtain funds through arrangements that may require us to relinquish rights to certain of our products, technologies or potential markets, either of which could have a material adverse effect on our business, financial condition and results of operations. To the extent that additional capital is raised through the sale of equity or convertible debt securities, the issuance of such securities would result in ownership dilution to our existing stockholders.

Our cash and investments policy emphasizes liquidity and preservation of principal over other portfolio considerations. We select investments that maximize interest income to the extent possible given these two constraints. We satisfy liquidity requirements by investing excess cash in securities with different maturities to match projected cash needs and limit concentration of credit risk by diversifying our investments among a variety of high credit-quality issuers.

Off-Balance Sheet Arrangements

We have not utilized off-balance sheet arrangements to fund our operations or otherwise manage our financial position.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.
Interest Rate Sensitivity

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. Fixed rate securities and borrowings may have their fair market value adversely impacted due to fluctuations in interest rates, while floating rate securities may produce less income than expected if interest rates fall and floating rate borrowings may lead to additional interest expense if interest rates increase. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities which have declined in market value due to changes in interest rates.

Our primary investment objective is to preserve principal while at the same time maximizing yields without significantly increasing risk. Our portfolio includes money markets funds, commercial paper, medium-term notes, corporate notes, government securities and corporate bonds. The diversity of our portfolio helps us to achieve our investment objectives. As of December 31, 2010, approximately 93% of our investment portfolio is composed of investments with original maturities of one year or less and approximately 14% of our investment portfolio matures less than 90 days from the date of purchase.

The following table presents the amounts of our cash equivalents and investments that may be subject to interest rate risk and the average interest rates as of December 31, 2010 by year of maturity (dollars in thousands):

	2011	2012	Total
Cash equivalents:			
Fixed rate	$ 5,615	$	$ 5,615
Average fixed rate	0.19%		0.19%
Variable rate	$ 502	$	$ 502
Average variable rate	0.11%		0.11%
Short-term investments:			
Fixed rate	$ 35,005	$	$ 35,005
Average fixed rate	0.50%		0.50%

Table of Contents

	2011	2012	Total
Long-term investments:			
Fixed rate	$	$ 3,197	$ 3,197
Average fixed rate		0.57%	0.57%
Restricted investments:			
Fixed rate	$ 933	$	$ 933
Average fixed rate	0.16%		0.16%
Total investment securities	$ 42,055	$ 3,197	$ 45,252
Average rate	0.44%	0.57%	0.46%

The following table presents the amounts of our cash equivalents and investments that may be subject to interest rate risk and the average interest rates as of December 31, 2009 by year of maturity (dollars in thousands):

	2010	2011	Total
Cash equivalents:			
Fixed rate	$ 2,350	$	$ 2,350
Average fixed rate	0.16%		0.16%
Variable rate	$ 4,157	$	$ 4,157
Average variable rate	0.08%		0.08%
Short-term investments:			
Fixed rate	$ 32,834	$	$ 32,834
Average fixed rate	0.53%		0.53%
Long-term investments:			
Fixed rate	$	$	$
Average fixed rate			
Restricted investments:			
Fixed rate	$ 431	$	$ 431
Average fixed rate	0.30%		0.30%
Total investment securities	$ 39,772	$	$ 39,772
Average rate	0.47%	$	0.47%

Table of Contents

Item 8. Financial Statements and Supplementary Data.

DURECT CORPORATION

INDEX TO FINANCIAL STATEMENTS

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of DURECT Corporation

We have audited the accompanying balance sheets of DURECT Corporation as of December 31, 2010 and 2009, and the related statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2010. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of DURECT Corporation at December 31, 2010 and 2009, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), DURECT Corporation s internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 3, 2011 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Palo Alto, California

March 3, 2011

Table of Contents

DURECT CORPORATION

BALANCE SHEETS

(in thousands, except per share amounts)

	December 31, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,437	$ 8,287
Short-term investments	35,005	32,834
Short-term restricted investments	66	
Accounts receivable (net of allowances of $107 at December 31, 2010 and $103 at December 31, 2009)	3,716	1,700
Inventories	2,836	2,799
Prepaid expenses and other current assets	2,785	1,433
Total current assets	54,845	47,053
Property and equipment, net	1,776	3,808
Goodwill	6,399	6,399
Intangible assets, net	71	108
Long-term investments	3,197	
Long-term restricted investments	867	431
Other long-term assets	405	352
Total assets	$ 67,560	$ 58,151
LIBILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 981	$ 1,019
Accrued liabilities	6,524	5,337
Contract research liabilities	2,109	990
Deferred revenue, current portion	8,079	4,703
Other short-term liabilities	216	208
Total current liabilities	17,909	12,257
Deferred revenue, non-current portion	34,849	17,543
Other long-term liabilities	315	508
Commitments		
Stockholders equity:		
Common stock, $0.0001 par value: 200,000 shares authorized; 87,053 and 86,755 shares issued and outstanding at December 31, 2010 and 2009, respectively	8	8
Additional paid-in capital	351,251	341,705
Accumulated other comprehensive income	6	10
Accumulated deficit	(336,778)	(313,880)
Stockholders equity	14,487	27,843
Total liabilities and stockholders equity	$ 67,560	$ 58,151

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

69

Table of Contents

DURECT CORPORATION

STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Year ended December 31,		
	2010	**2009**	**2008**
Collaborative research and development and other revenue	$ 20,091	$ 12,347	$ 19,770
Product revenue, net	11,500	12,113	8,765
Total revenues	31,591	24,460	28,535
Operating expenses:			
Cost of revenues(1)	4,275	5,311	3,365
Research and development(1)	36,214	34,801	40,845
Selling, general and administrative(1)	14,937	15,020	15,510
Write-down of deferred royalties and commercial rights			13,480
Total operating expenses	55,426	55,132	73,200
Loss from operations	(23,835)	(30,672)	(44,665)
Other income (expense):			
Interest and other income	943	420	1,547
Interest expense	(6)	(36)	(789)
Net other income (expense)	937	384	758
Net loss	$ (22,898)	$ (30,288)	$ (43,907)
Net loss per share, basic and diluted	$ (0.26)	$ (0.36)	$ (0.56)
Shares used in computing basic and diluted net loss per share	86,868	83,427	78,332
(1) Includes stock-based compensation related to the following:			
Cost of revenues	$ 341	$ 433	$ 135
Research and development	4,941	7,159	5,575
Selling, general and administrative	2,520	3,838	2,790
	$ 7,802	$ 11,430	$ 8,500

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

Table of Contents

DURECT CORPORATION

STATEMENT OF STOCKHOLDERS EQUITY

(in thousands)

	Common Stock						
	Shares	Amount	Additional Paid-In Capital	Deferred Royalties And Commercial Rights	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders Equity
Balance at December 31, 2007	74,107	$ 7	$ 287,689	$ (13,480)	$ 50	$ (239,685)	$ 34,581
Issuance of common stock upon exercise of stock options and purchases of ESPP shares	419		1,264				1,264
Stock-based compensation expense from stock options and ESPP shares			8,516				8,516
Conversion of subordinated convertible notes	7,492	1	23,598				23,599
Write-down of deferred royalties and commercial rights				13,480			13,480
Net change in unrealized gain on available-for-sale securities					31		31
Net loss						(43,907)	(43,907)
Total comprehensive net loss							(43,876)
Balance at December 31, 2008	82,018	8	321,067		81	(283,592)	37,564
Issuance of common stock upon exercise of stock options and purchases of ESPP shares	293		528				528
Stock-based compensation expense from stock options and ESPP shares			10,236				10,236
Issuance of common stock upon equity financing	4,444		9,874				9,874
Net change in unrealized gain on available-for-sale securities					(71)		(71)
Net loss						(30,288)	(30,288)
Total comprehensive net loss							(30,359)
Balance at December 31, 2009	86,755	8	341,705		10	(313,880)	27,843
Issuance of common stock upon exercise of stock options and purchases of ESPP shares	298		565				565
Stock-based compensation expense from stock options and ESPP shares			8,981				8,981
Net change in unrealized gain on available-for-sale securities					(4)		(4)
Net loss						(22,898)	(22,898)
Total comprehensive net loss							(22,902)
Balance at December 31, 2010	87,053	$ 8	$ 351,251	$	$ 6	$ (336,778)	$ 14,487

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

71

Table of Contents

DURECT CORPORATION

STATEMENTS OF CASH FLOWS

(in thousands)

	Year ended December 31,		
	2010	**2009**	**2008**
Cash flows from operating activities			
Net loss	$ (22,898)	$ (30,288)	$ (43,907)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Write-down of deferred royalties and commercial rights			13,480
Depreciation	2,214	2,457	2,580
Amortization	37	49	48
Stock-based compensation	7,802	11,430	8,500
Asset retirement obligation		383	
Loss on impairment and disposal of fixed assets	74		4
Inventory write-off	249	487	529
Changes in assets and liabilities:			
Accounts receivable	(2,016)	2,355	(433)
Inventories	(303)	190	(2,024)
Prepaid expenses and other assets	(1,405)	341	56
Accounts payable	(38)	1	(816)
Accrued liabilities	2,246	(1,534)	(449)
Contract research liability	1,119	(5)	(951)
Interest payable on convertible notes			(61)
Deferred revenue	20,682	(6,760)	14,010
Total adjustments	30,661	9,394	34,473
Net cash provided by (used in) operating activities	7,763	(20,894)	(9,434)
Cash flows from investing activities			
Purchase of property and equipment	(256)	(294)	(897)
Purchase of intangible assets			(25)
Purchase of available-for-sale securities	(67,150)	(46,894)	(21,487)
Proceeds from sales of available-for-sale securities	2,207	1,154	
Proceeds from maturities of available-for-sale securities	59,069	35,651	22,698
Net cash provided by (used in) investing activities	(6,130)	(10,383)	289
Cash flows from financing activities			
Payments on equipment financing obligations	(48)	(43)	(38)
Payment on debt obligations		(240)	(225)
Net proceeds from issuances of common stock	565	528	1,264
Net proceeds from issuance of common stock in connection with equity financing		9,874	
Net cash provided by financing activities	517	10,119	1,001
Net increase (decrease) in cash and cash equivalents	2,150	(21,158)	(8,144)
Cash and cash equivalents at beginning of year	8,287	29,445	37,589
Cash and cash equivalents at end of year	$ 10,437	$ 8,287	$ 29,445
Supplemental disclosure of cash flow information			
Cash paid for interest	$ 5	$ 27	$ 785

Supplemental disclosure of noncash investing and financing activities			
Conversion of convertible subordinated notes for common stock	$	$	$ 23,599

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

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Nature of Operations

DURECT Corporation (the Company) was incorporated in the state of Delaware on February 6, 1998. The Company is a pharmaceutical company developing therapies based on its proprietary drug formulations and delivery platform technologies. The Company has several products under development by itself and with third party collaborators. The Company also manufactures and sells osmotic pumps used in laboratory research, and designs, develops and manufactures a wide range of standard and custom biodegradable polymers and excipients for pharmaceutical and medical device clients for use as raw materials in their products. In addition, the Company conducts research and development of pharmaceutical products in collaboration with third party pharmaceutical and biotechnology companies.

Basis of Presentation and Use of Estimates

The Company s financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP). The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Actual results could differ materially from those estimates. Specifically, management makes estimates when preparing the financial statements including those related to goodwill and other intangible assets, accrued liabilities, contract research liabilities, inventories and stock-based compensation.

Reclassifications

Certain prior period amounts in the statements of operations have been reclassified to conform to current period presentation. The Company reclassified $167,000 and $1.4 million related to the Company s agreement with Nycomed from research and development expenses to collaborative research and development and other revenue for the years ended 2009 and 2008, respectively. Such reclassification did not impact the Company s net loss or financial position.

Cash, Cash Equivalents and Investments

The Company considers all highly liquid investments with maturities of 90 days or less from the date of purchase to be cash equivalents. Investments with original maturities of greater than 90 days from the date of purchase but less than one year from the balance sheet date are classified as short-term investments, while investments with maturities in one year or beyond one year from the balance sheet date are classified as long-term investments. Management determines the appropriate classification of its cash equivalents and investment securities at the time of purchase and re-evaluates such determination as of each balance sheet date. Management has classified the Company s cash equivalents and investments as available-for-sale securities in the accompanying financial statements. Available-for-sale securities are carried at fair value, with unrealized gains and losses reported as a component of accumulated other comprehensive income (loss). Realized gains and losses are included in interest income. There were no material realized gains or losses in the periods presented. The cost of securities sold is based on the specific identification method.

The Company invests in debt instruments of government agencies and corporations, and money market funds with high credit ratings. The Company has established guidelines regarding diversification of its investments and their maturities with the objectives of maintaining safety and liquidity, while maximizing yield.

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to credit risk consist principally of interest-bearing investments and trade receivables. The Company maintains cash, cash equivalents and investments with various major financial institutions. The Company performs periodic evaluations of the relative credit standing of these financial institutions and limits the amount of credit exposure with any one institution. In addition, the Company performs periodic evaluations of the relative credit quality of its investments.

Pharmaceutical companies and academic institutions account for a substantial portion of the Company s trade receivables. The Company provides credit in the normal course of business to its customers and collateral for these receivables is generally not required. The risk associated with this concentration is limited due to the large number of accounts and their geographic dispersion. The Company monitors the creditworthiness of its customers to which it grants credit terms in the normal course of business. The Company maintains reserves for estimated credit losses and, to date, such losses have been within management s expectations. At December 31, 2010, Hospira, King and Pain Therapeutics accounted for 33%, 19% and 15% of the Company s net accounts receivable. At December 31, 2009, King and one of the Company s feasibility partners accounted for 39% and 11% of the Company s net accounts receivable.

Customer and Product Line Concentrations

A portion of the Company s revenue is derived from its ALZET mini pump product line, LACTEL biodegradable polymer product line and the sale of certain excipients for Remoxy. In 2010, revenue from the ALZET product line and the LACTEL product line accounted for 22% and 11% of total revenue, respectively. In 2009, revenue from ALZET mini pump product line, the sale of certain excipients for Remoxy and the LACTEL product line accounted for 26%, 12% and 11% of total revenue, respectively. In 2008, revenue from the ALZET product line accounted for 23% of total revenues.

In 2010, King and Hospira accounted for 33% and 18% of the Company s total revenues, respectively. In 2009, King accounted for 41% of the Company s total revenues. In 2008, Pain Therapeutics, Nycomed, Endo and Alpharma accounted for 22%, 16%, 14% and 12% of the Company s total revenues, respectively.

Total revenue by geographic region for the years 2010, 2009 and 2008 is as follows (in thousands):

	Year ended December 31,		
	2010	**2009**	**2008**
United States	$ 25,459	$ 18,410	$ 20,664
Europe	4,436	3,689	6,245
Japan	863	927	1,032
Other	833	1,434	594
Total	$ 31,591	$ 24,460	$ 28,535

Revenue by geography is determined by the location of the customer.

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

Inventories

Inventories are stated at the lower of cost or market, with cost determined on a first-in, first-out basis. The Company s inventories consisted of the following (in thousands):

	December 31,	
	2010	2009
Raw materials	$ 519	$ 516
Work in-process	840	690
Finished goods	1,477	1,593
Total inventories	$ 2,836	$ 2,799

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation, which is computed using the straight-line method over the estimated useful lives of the assets, which range from three to five years. Leasehold improvements are amortized using the straight-line method over the estimated useful lives of the assets, or the terms of the related leases, whichever are shorter.

Acquired Intangible Assets and Goodwill

Acquired intangible assets consist of patents, developed technology, trademarks and customer lists related to the Company s acquisitions accounted for using the purchase method. Amortization of these purchased intangibles is calculated on a straight-line basis over the respective estimated useful lives of the assets ranging from four to seven years. The Company assesses goodwill for impairment at least annually.

Impairment of Long-Lived Assets

The Company reviews long-lived assets, including property and equipment, intangible assets, and other long-term assets, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. Factors we consider important which could trigger an impairment review include, but are not limited to, the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business;
- significant negative industry or economic trends;
- significant decline in our stock price for a sustained period; and

a significant change in our market capitalization relative to net book value.

An impairment loss would be recognized when estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Impairment, if any, is calculated as the amount by which an asset s carrying value exceeds its fair value, typically using discounted cash flows to determine fair value. Through December 31, 2010, there have been no material impairment losses.

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

Stock-Based Compensation

The Company accounts for share-based payments using a fair-value based method for costs related to all share-based payments, including stock options and stock issued under our employee stock purchase plan (ESPP). The Company estimates the fair value of share based payment awards on the date of grant using an option-pricing model. See Note 8 for further information regarding stock-based compensation.

Revenue Recognition

Revenue from the sale of products is recognized when there is persuasive evidence that an arrangement exists, the product is shipped and title transfers to customers, provided no continuing obligation on the Company s part exists, the price is fixed or determinable and the collectability of the amounts owed is reasonably assured. The Company enters into license and collaboration agreements under which it may receive up-front license fees, research funding and contingent milestone payments and royalties. The Company s deliverables under these arrangements typically consist of granting licenses to intellectual property rights and research and development services. The accounting standards contain a presumption that separate contracts entered into at or near the same time with the same entity or related parties were negotiated as a package and should be evaluated as a single agreement. The Company evaluates whether there is stand-alone value for the delivered elements and objective and reliable evidence of fair value to allocate revenue to each element in multiple element agreements. When the delivered element does not have stand-alone value or there is insufficient evidence of fair value for the undelivered element(s), the Company recognizes the consideration for the combined unit of accounting in the same manner as the revenue is recognized for the final deliverable, which is generally ratably over the longest period of involvement. Returns or credits related to the sale of products have not had a material impact on the Company s revenues or net loss.

Upfront payments received upon execution of collaborative agreements are recorded as deferred revenue and recognized as collaborative research and development revenue based on a straight-line basis over the period of the Company s continuing involvement with the third-party collaborator pursuant to the applicable agreement. Such period generally represents the longer of the estimated research and development period or other continuing obligation period defined in the respective agreements between the Company and its third-party collaborators.

Research and development revenue related to services performed under the collaborative arrangements with the Company s third-party collaborators is recognized as the related research and development services are performed. These research payments received under each respective agreement are not refundable and are generally based on reimbursement of qualified expenses, as defined in the agreements. Research and development expenses under the collaborative research and development agreements generally approximate or exceed the revenue recognized under such agreements over the term of the respective agreements. Deferred revenue may result when the Company does not expend the required level of effort during a specific period in comparison to funds received under the respective agreement. For joint control and funding development activities, the Company recognizes revenue from the net reimbursement of the research and development expenses from our partner and records the net payment of research and development expenses to our partner as additional research and development expense.

Milestone payments under collaborative arrangements are recognized as collaborative research and development revenue upon achievement of the at risk milestone events, which represent the culmination of the earnings process related to that milestone as defined in the agreement. Milestone payments are triggered either by the results of our research and development efforts or by events external to us, such as regulatory approval to market a product or the achievement of specified sales levels by a third-party collaborator. As such, the

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

milestones are substantially at risk at the inception of the collaboration agreement, and revenue is only recognized upon the achievement of a milestone event if the Company has no future performance obligations related to that milestone payment.

Revenue on cost-plus-fee contracts, such as under contracts to perform research and development for others, is recognized as the related services are rendered as determined by the extent of reimbursable costs incurred plus estimated fees thereon.

The collaborative research and development and other revenues associated with the Company s major third-party collaborators are as follows (in thousands):

	Year ended December 31,		
	2010	2009	2008
Collaborator			
King Pharmaceuticals, Inc. (King)	$ 9,487	$ 7,024	$ 3,412
Hospira Inc. (Hospira)	5,551		
Nycomed Danmark ApS (Nycomed)	2,033	1,620	4,485
Pain Therapeutics, Inc. (Pain Therapeutics)	1,456	317	6,410
Endo Pharmaceuticals, Inc. (Endo)		985	3,934
Others	1,564	2,401	1,529
Total collaborative research and development and other revenue	$ 20,091	$ 12,347	$ 19,770

Research and Development Expenses

Research and development expenses are primarily comprised of salaries and benefits associated with research and development personnel, overhead and facility costs, preclinical and non-clinical development costs, clinical trial and related clinical manufacturing costs, contract services, and other outside costs. Research and development costs are expensed as incurred. Research and development costs paid to third parties under sponsored research agreements are recognized as the related services are performed. In addition, net reimbursements of research and development expenses by our partners incurred are recorded as collaborative research and development revenue. Net payments of research and development expenses to our partners are recorded as an addition to our research and development expenses in the period incurred.

Comprehensive Loss

Components of other comprehensive loss comprised entirely of unrealized gains and losses on the Company s available-for-sale securities for all periods presented, are included in total comprehensive loss as follows (in thousands).

	Year Ended December 31,		
	2010	2009	2008
Net loss	$ (22,898)	$ (30,288)	$ (43,907)
Net change in unrealized gain on available-for-sale securities, net of tax	(4)	(71)	31
Comprehensive loss	$ (22,902)	$ (30,359)	$ (43,876)

Accumulated other comprehensive income (loss) as of December 31, 2010, 2009 and 2008 is entirely comprised of unrealized gains or losses on available-for-sale securities.

77

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

Segment Reporting

The Company operates in one operating segment, which is the research, development and manufacturing of pharmaceutical products.

Net Loss Per Share

Basic net loss per share is calculated by dividing the net loss by the weighted-average number of common shares outstanding. Diluted net loss per share is computed using the weighted-average number of common shares outstanding and common stock equivalents (i.e., options and warrants to purchase common stock, convertible subordinated notes) outstanding during the year, if dilutive, using the treasury stock method for options and warrants and the if-converted method for convertible subordinated notes.

The computation of diluted net loss per share for the fiscal year ended December 31, 2010 excludes the impact of options to purchase 19.6 million shares of common stock, and a warrant to purchase 770 shares of common stock outstanding at December 31, 2010, as such impact would be antidilutive.

The computation of diluted net loss per share for the fiscal year ended December 31, 2009 excludes the impact of options to purchase 16.7 million shares of common stock, and a warrant to purchase 770 shares of common stock outstanding at December 31, 2009, as such impact would be antidilutive.

The computation of diluted net loss per share for the fiscal year ended December 31, 2008 excludes the impact of options to purchase 14.0 million shares of common stock, a warrant to purchase 770 shares of common stock outstanding at December 31, 2008 and 3.4 million shares of common stock associated with convertible subordinated notes prior to their conversion at June 15, 2008, as such impact would be antidilutive.

Shipping and Handling

Costs related to shipping and handling are included in cost of revenues for all periods presented.

Operating Leases

The Company leases administrative, manufacturing and laboratory facilities under operating leases. Lease agreements may include rent holidays, rent escalation clauses and tenant improvement allowances. The Company recognizes scheduled rent increases on a straight-line basis over the lease term beginning with the date the Company takes possession of the leased space. The Company records tenant improvement allowances as deferred rent liabilities and amortizes the deferred rent over the terms of the lease to rent expense on the statements of operations.

Recent Accounting Pronouncements

In October 2009, the FASB issued ASU No. 2009-13, Revenue Recognition *Multiple Deliverable Revenue Arrangements* (ASU 2009-13). ASU 2009-13 provides application guidance on whether multiple deliverables exist, how the deliverables should be separated and how the consideration should be allocated to one or more units of accounting. This update establishes a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence, if available, third-party evidence if vendor-specific objective evidence is not available, or estimated selling price if neither vendor-specific or third-party evidence is available. The Company has adopted this guidance prospectively beginning on January 1, 2011. Under ASU 2009-13, the Company may be required to exercise

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

considerable judgment in determining the estimated selling price of delivered items under new agreements and the Company s revenue under new agreements may be more accelerated as compared to the prior accounting standard. As such, the adoption of ASU 2009-13 could have a material impact on the Company s financial statements going forward.

2. Strategic Agreements

Agreement with Hospira, Inc.

In June 2010, the Company and Hospira, Inc. (Hospira) entered into a license agreement to develop and market POSIDUR (SABER-bupivacaine) in the U.S. and Canada. POSIDUR is the Company s investigational post-operative pain relief depot currently in Phase III clinical development in the U.S. that utilizes the Company s patented SABER technology to deliver bupivacaine to provide up to three days of pain relief after surgery. POSIDUR is licensed to Nycomed for commercialization in Europe and other specified countries, and the Company retains commercialization rights in Japan and all other countries not licensed to Hospira and Nycomed.

Under terms of the agreement, Hospira made an upfront payment of $27.5 million, with the potential for up to an additional $185 million in performance milestone payments based on the successful development, approval and commercialization of POSIDUR in the U.S. and Canada. For the U.S. and Canada, the two companies will jointly direct and equally fund the remaining development costs for POSIDUR, while Hospira will have exclusive commercialization rights upon regulatory approval with sole funding responsibility for commercialization activities. In addition, the Company has also granted to Hospira the right to develop and commercialize in the U.S. and Canada, at Hospira s sole cost, other specified local anesthetic products, if any, based on the SABER technology, which come into existence under the Agreement. Hospira will be responsible for commercial manufacture of licensed products under the Agreement, provided that the Company will supply to Hospira a specified excipient for use in the manufacture of licensed products pursuant to a supply agreement entered into by the parties. On a product by product basis, Hospira will pay the Company a royalty on sales of each licensed product commercialized under the Agreement for a defined period, after which the license granted to Hospira for such product shall convert to a fully paid-up, non-royalty bearing and perpetual license. The term of the agreement shall be for the duration of Hospira s obligation to pay royalties for product sales under the Agreement. The agreement provides each party with specified termination rights, including the right of Hospira to terminate at will after a specified period and each party to terminate the agreement upon material breach of the agreement by the other party. The agreement also contains terms and conditions customary for this type of arrangement, including representations, warranties and indemnities.

The following table provides a summary of amounts comprising the Company s net share of the research and development costs for POSIDUR under the agreement with Hospira (in thousands):

	Year Ended December 31,		
	2010	2009	2008
Research and development expenses reimbursable by Hospira	$ 3,436	$	$
Research and development expenses reimbursable by the Company			
Net payable to Hospira	$	$	$
Net receivable from Hospira	$ 3,436	$	$

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

The following table provides a summary of collaborative research and development revenue recognized under the agreement with Hospira (in thousands). The cumulative aggregate payments received by the Company as of December 31, 2010 were $29.7 million under this agreement.

	Year Ended December 31,		
	2010	2009	2008
Ratable recognition of upfront payment(1)	$ 2,115	$	$
Research and development expenses reimbursable by Hospira	3,436		
Total collaborative research and development revenue	$ 5,551	$	$

(1) The Company s estimate of the term of its continuing involvement is based on the later of the research and development period and the term of the Company s manufacturing obligation under the development and license agreement with Hospira.

Agreement with Alpharma Ireland Limited, an affiliate of Alpharma Inc. (Alpharma) (acquired by King which subsequently was acquired by Pfizer)

Effective October 2008, the Company and Alpharma, entered into a development and license agreement granting Alpharma the exclusive worldwide rights to develop and commercialize ELADUR, DURECT s investigational transdermal bupivacaine patch. As a result of the acquisition of Alpharma by King in December 2008, King assumed the rights and obligations of Alpharma under the agreement. As a result of the acquisition of King by Pfizer in February 2011, Pfizer has assumed the rights and obligations of King under the agreement.

Under the terms of the agreement, upon closing of the transaction, Alpharma paid the Company an upfront license fee of $20.0 million, with possible additional payments of up to $93.0 million upon the achievement of predefined development and regulatory milestones spread over multiple clinical indications and geographical territories as well as possible additional payments of up to $150.0 million in sales-based milestones. If ELADUR is commercialized, the Company would also receive royalties on product sales. Alpharma will control and fund further development of the program. The term of the agreement will continue on a jurisdiction-by-jurisdiction basis until the later of fifteen (15) years from the date of first commercial sale of ELADUR or the expiration of patent coverage or data exclusivity in such jurisdiction. During the term of the agreement, subject to specified conditions, neither party nor their affiliates may develop or commercialize a transdermal patch containing bupivacaine. Upon expiration of the term of the agreement, the rights and licenses granted to Alpharma shall convert to fully paid-up, non-royalty bearing, perpetual rights and licenses. The agreement provides each party with specified termination rights, including the right of Alpharma to terminate at any time without cause and each party to terminate the agreement upon material breach of the agreement by the other party. The agreement also contains terms and conditions customary for this type of arrangement, including representations, warranties and indemnities.

The following table provides a summary of collaborative research and development revenue recognized under the agreement with King with regard to ELADUR (in thousands). The cumulative aggregate payments received by the Company as of December 31, 2010 were $27.6 million under this agreement.

	Year Ended December 31,		
	2010	2009	2008
Ratable recognition of upfront payment(1)	$ 3,218	$ 3,427	$ 752
Research and development expenses reimbursable by King	2,673	2,614	2,660
Total collaborative research and development revenue	$ 5,891	$ 6,041	$ 3,412

(1) The Company s estimate of the remaining term of its continuing involvement was modified in the second quarter of 2009 as a result of an updated development plan.

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

Agreement with Nycomed

In November 2006, the Company entered into a development and license agreement with Nycomed, and this agreement was amended in February 2010 and February 2011. Under the terms of the agreement, the Company licensed to Nycomed the exclusive commercialization rights to POSIDUR for the European Union (E.U.) and certain other countries. Nycomed paid an upfront license fee of $14.0 million in 2006 and a milestone payment of $8.0 million in 2007, with future potential additional milestone payments of up to $181.0 million upon achievement of defined development, regulatory and sales milestones. Prior to the February 2010 amendment, the agreement provided for the Company and Nycomed to jointly direct and equally fund a development program for POSIDUR intended to secure regulatory approval in both the U.S. and the E.U. After the amendment, DURECT now has final decision-making authority over clinical trials intended for the U.S. registration of POSIDUR and Nycomed now has decision-making authority over clinical trials for the E.U. and other countries licensed to it. DURECT will have funding responsibility for all current and future clinical trials intended for U.S. registration of POSIDUR and, commencing April 1, 2010, Nycomed has sole funding responsibility over clinical trials for the E.U. and other countries licensed to it. The final decision making authority and financial responsibility for the remainder of the development activities, such as the non-clinical and CMC activities, will be jointly managed and funded by DURECT and Nycomed. In February 2011, the agreement was further amended such that during the period commencing from January 1, 2011 until a specified period after the results are delivered from DURECT to Nycomed from DURECT s U.S. Phase III clinical trial for POSIDUR referred to as BESST (Bupivacaine Effectiveness and Safety in SABER Trial) (such period the Interim Period), DURECT shall assume full funding responsibility and final decision making authority for these activities. Furthermore, during this Interim Period, Nycomed s development and commercialization responsibility relating to POSIDUR for the territory licensed to Nycomed shall be confined to bringing its E.U. Phase IIb Clinical Trial in shoulder surgery to a full completion. Unless the agreement is otherwise terminated, at the conclusion of the Interim Period, under the 2011 amendment, Nycomed would resume joint control and shared funding responsibility with DURECT for the non-clinical and Chemistry Manufacturing and Controls (CMC) activities for POSIDUR for the U.S. and E.U. territories. Prior to the 2011 amendment, Nycomed had the right to terminate the Agreement after specified periods after data was received from certain clinical trials of POSIDUR in the E.U. and the U.S., including BESST. The foregoing right was modified by the 2011 amendment to provide that Nycomed may exercise its right to terminate the Agreement at its sole election if BESST data was not available by December 31, 2011. In addition, the Company will be responsible for manufacturing and supplying the product to Nycomed for commercial sale in the territory licensed to Nycomed. Nycomed will pay the Company blended royalties on sales in the defined territory of 15-40% depending on annual sales, as well as a manufacturing markup. The Company retains full commercial rights to POSIDUR in all other countries not specifically licensed to Nycomed or Hospira. The agreement shall continue in effect until terminated. The agreement provides each party with specified termination rights, including the right of each party to terminate the agreement upon material breach of the agreement by the other party. In addition, Nycomed shall have the right to terminate the agreement after expiration of patents covering POSIDUR in all major market countries in the E.U. and for adverse product events, and within specified periods after clinical trials of POSIDUR.

For joint control and funding development activities, the Company recognizes revenue from the net reimbursement of the research and development expenses from Nycomed and records the net payment of research and development expenses to Nycomed as additional research and development expense. The Company and Nycomed each bear 50% of these agreed upon expenses under the collaboration agreement for POSIDUR.

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

The following tables provide a summary of the amounts comprising our net share of the research and development costs for POSIDUR under the Company s agreement with Nycomed (in thousands):

	Year Ended December 31,		
	2010	2009	2008
Research and development expenses reimbursable by Nycomed	$ 1,466	$ 3,510	$ 3,581
Research and development expenses reimbursable by the Company	(966)	(4,674)	(2,147)
Net payable to Nycomed	$ (298)	$ (1,331)	$
Net receivable from Nycomed	$ 798	$ 167	$ 1,434

The following table provides a summary of collaborative research and development revenue recognized under the agreement with Nycomed with regard to POSIDUR (in thousands). The cumulative aggregate payments received by the Company from Nycomed as of December 31, 2010 were $36.1 million under this agreement. In addition, the cumulative aggregate payments paid by the Company to Nycomed were $9.0 million as of December 31, 2010.

	Year Ended December 31,		
	2010	2009	2008
Ratable recognition of upfront payment(1)	$ 1,235	$ 1,453	$ 3,051
Research and development expenses reimbursable by Nycomed	798	167	1,434
Total collaborative research and development revenue	$ 2,033	$ 1,620	$ 4,485

(1) The Company s estimates of the remaining term of its continuing involvement were modified in the first and fourth quarters of 2009 as a result of an updated development plan for POSIDUR in Europe.

Agreement with Pain Therapeutics, Inc.

In December 2002, the Company entered into an exclusive agreement with Pain Therapeutics, Inc. (Pain Therapeutics) to develop and commercialize on a worldwide basis Remoxy and other oral sustained release, abuse deterrent opioid products incorporating four specified opioid drugs, using the ORADUR technology. The agreement also provides Pain Therapeutics with the exclusive right to commercialize products developed under the agreement on a worldwide basis. In connection with the execution of the agreement, Pain Therapeutics paid the Company upfront fees of $900,000 in December 2002 and $100,000 in October 2003. In December 2005, the Company amended its agreement with Pain Therapeutics in order to specify its obligations with respect to the supply of key excipients for use in the licensed products. Under the agreement, as amended, the Company is responsible for formulation development, supply of selected key excipients used in the manufacture of licensed products and other specified tasks. Under the agreement with Pain Therapeutics, subject to and upon the achievement of predetermined development and regulatory milestones for the four drug candidates currently in development, the Company is entitled to receive milestone payments of up to $9.3 million in the aggregate. As of December 31, 2009, the Company had received $1.7 million in cumulative milestone payments. In addition, if commercialized, the Company will receive royalties for Remoxy and other licensed products which do not contain an opioid antagonist of between 6.0% to 11.5% of net sales of the product depending on sales volume. This agreement can be terminated by either party for material breach by the other party and by Pain Therapeutics without cause. Under the agreement, Pain Therapeutics reimburses the Company for qualified expenses incurred

82

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

by the Company in connection with the development program. The Company recognizes collaborative research and development revenue related to research and development activities for Remoxy and other development programs based on reimbursement of qualified expenses as defined in the collaborative agreement and related amendment with Pain Therapeutics. Total collaborative research and development revenue recognized under the agreements with Pain Therapeutics was $1.5 million, $317,000 and $6.4 million in 2010, 2009 and 2008, respectively. The cumulative aggregate payments received by the Company as of December 31, 2010 were $32.2 million under this agreement.

In March 2009, King assumed the responsibility for further development of Remoxy from Pain Therapeutics. As a result of this change, the Company continues to perform Remoxy-related activities in accordance with the terms and conditions set forth in the license agreement between the Company and Pain Therapeutics. Now King is substituted in lieu of Pain Therapeutics with respect to interactions with the Company in its performance of those activities including the obligation to pay the Company with respect to all Remoxy-related costs incurred by the Company. In February 2011, Pfizer acquired King and thereby assumed the rights and obligations of King with respect to Remoxy.

Total collaborative research and development revenue recognized for Remoxy-related work performed by the Company for King was $3.4 million, $983,000 and zero for the years ended December 31, 2010, 2009 and 2008, respectively. Prior to March 2009, the Company recognized collaborative research and development revenue for Remoxy related work under the agreements with Pain Therapeutics. The cumulative aggregate payments received by the Company from King as of December 31, 2010 were $4.2 million under this agreement.

Long Term Supply Agreement with King (now Pfizer)

During 2008, the Company began to manufacture commercial lots of certain key excipients that are included in Remoxy to meet the anticipated requirements for these components. In addition, during the second, third and fourth quarters of 2008 and the first quarter of 2009, the Company made shipments of these materials to meet the production requirements of King, which has rights to commercialize Remoxy upon approval by the FDA. During these periods, all product revenue and associated cost of goods sold was deferred pending the establishment of definitive final terms and conditions even though cash receipts and expenditures occurred during these periods.

In August 2009, the Company signed an exclusive long term excipient supply agreement with respect to REMOXY with King. On February 28, 2011 Pfizer acquired King and thereby assumed the rights and obligations of King with respect to this long term supply agreement. This agreement stipulates the terms and conditions under which the Company will supply to King, based on the Company s manufacturing cost plus a specified percentage mark-up, two key excipients used in the manufacture of REMOXY. In the third quarter of 2009, the Company recognized $3.0 million of product revenue and $2.0 million of cost of goods sold related to its past shipments to King upon execution of the long term supply agreement at which point all criteria of revenue recognition were met.

The term of the agreement commenced on August 5, 2009 and will continue in effect until the earlier of the expiration of all licenses granted under the development and license agreement between the Company and Pain Therapeutics or the termination or expiration of the 2005 development and license agreement between Pain Therapeutics and King, unless the agreement is terminated earlier in accordance with its terms. The agreement provides each party with specified termination rights, which include, but are not limited to, the right of King to terminate the agreement in the event that governmental action requires the withdrawal of REMOXY from all countries in the territory or results in the withdrawal of required manufacturing approvals, or upon a change of control of the Company, in which case termination will be effective one year after notice by King. The Company may terminate the agreement if the Company is unable to procure suitable and sufficient quantities of certain raw

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

materials required to produce the excipient ingredients. Each party may terminate the agreement upon material breach of the agreement by, or the bankruptcy or insolvency of, the other party, in each case subject to a cure period. The agreement further specifies the rights and obligations of the Company and King with respect to plant allocation, adding additional production capacity and sourcing of raw materials, as well as other terms and conditions customary for this type of agreement, including those regarding forecasting, purchasing, invoicing, representations, warranties and indemnities.

In 2010, the Company recognized $551,000 of product revenue for shipments made in 2008 and 2009 related to a price settlement after all criteria of revenue recognition were met. The price settlement related to additional manufacturing cost incurred by the Company and certain mark-up for the goods produced and shipped in 2008 and 2009 pursuant to the long term excipient supply agreement. In addition, the Company also recognized $410,000 of product revenue related to the shipment of another excipient that is included in Remoxy upon shipment to King in 2010. Total revenue recognized related to these excipients was $961,000 and $3.0 million in 2010 and 2009, respectively and the associated cost of goods sold was $315,000 and $2.0 million in 2010 and 2009, respectively.

Agreement with Endo Pharmaceuticals

On March 10, 2005, the Company entered into a license agreement with Endo under which the Company granted to Endo the exclusive right to develop, market and commercialize TRANSDUR-Sufentanil in the U.S. and Canada. The Company received an initial payment of $10.0 million in connection with the execution of the agreement. The license agreement was terminated by Endo effective August 26, 2009.

The $10.0 million upfront fee is recognized as revenue ratably over the term of the Company s obliged continuing involvement with Endo with respect to TRANSDUR-Sufentanil. The term of the continuing involvement had been estimated based on the product development plan pursuant to the agreement. The Company s estimate of the remaining term of its continuing involvement was modified in the fourth quarter of 2008 as a result of Endo s termination notice received by the Company in February 2009.

The Company recognized zero, $875,000 and $3.0 million, respectively as collaborative research and development revenue from the ratable recognition of the $10.0 million upfront fee for the years ended December 31, 2010, 2009 and 2008. Total collaborative research and development revenue recognized under this arrangement was zero, $985,000 and $3.9 million for the years ended December 31, 2010, 2009 and 2008, respectively. The cumulative aggregate payments received by the Company as of December 31, 2010 were $21.5 million under this agreement.

Agreement with EpiCept Corporation

In December 2006, the Company entered into a license agreement with EpiCept which provided the Company with the exclusive, worldwide license to certain of EpiCept s intellectual property for a transdermal patch containing bupivacaine for the treatment of back pain. Pursuant to the agreement, the Company paid EpiCept a $1.0 million upfront fee in 2006 and subject to the Company s achievement of specified milestones, agreed to pay EpiCept an additional $9.0 million in milestone payments as well as an undisclosed royalty on net sales of any product covered by the license. The $1.0 million fee was recognized as research and development expense at the execution of the agreement since the rights purchased had not yet reached technological feasibility and such rights also had no future alternative uses.

In September 2008, the Company and EpiCept entered into an amendment to the license agreement. Under the amendment, among other changes, the scope of the license was broadened from the treatment of back pain to

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

all uses covered by the EpiCept intellectual property including myofascial pain and muscle tension pain, and the license was converted to an exclusive, worldwide, fully paid up, royalty-free, perpetual and irrevocable license. In consideration of this amendment, the Company made a one-time payment of $2.25 million to EpiCept in full satisfaction of all future payment obligations to EpiCept under the license agreement. The Company recorded the payment of $2.25 million as a research and development expense in 2008 since the rights purchased had not yet reached technological feasibility and such rights also had no future alternative uses.

3. Intangible Assets and Goodwill

Intangible assets recorded in connection with our acquisitions consist of the following (in thousands):

	December 31, 2010		
	Gross Intangibles	Accumulated Amortization	Net Intangibles
Developed technology	$ 3,600	$ (3,600)	$
Patents	591	(520)	71
Other intangible assets	3,260	(3,260)	
Total	$ 7,451	$ (7,380)	$ 71

	December 31, 2009		
	Gross Intangibles	Accumulated Amortization	Net Intangibles
Developed technology	$ 3,600	$ (3,586)	$ 14
Patents	591	(497)	94
Other intangible assets	3,260	(3,260)	
Total	$ 7,451	$ (7,343)	$ 108

The intangible assets are being amortized on a straight-line basis over estimated useful lives ranging from four to seven years.

The net amount of intangible assets at December 31, 2010 was $71,000, which will be amortized as follows: $17,600 in each of the years from 2011 to 2014, and $600 in 2015. Should any intangible assets become impaired, the Company will write them down to their estimated fair value.

Goodwill totaled $6.4 million at December 31, 2010. The Company evaluates goodwill for impairment at least annually. In 2010, 2009 and 2008 goodwill was evaluated and no indicators of impairment were noted. Should goodwill become impaired, the Company may be required to record an impairment charge. To date, the Company has not recorded any impairment charge to goodwill.

4. Financial Instruments

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company s valuation techniques used to measure fair value maximize the use of observable inputs and minimize the use of unobservable inputs. The Company follows a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value. These levels of inputs are the following:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

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

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

The Company s financial instruments are valued using quoted prices in active markets or based upon other observable inputs. The following table sets forth the fair-value of the Company s financial assets that were measured on at fair value a recurring basis as of December 31, 2010 (in thousands):

	Level 1	Level 2	Level 3	Total
Money market funds	$ 502	$	$	$ 502
Certificates of deposit		1,282		1,282
Commercial paper		11,405		11,405
Corporate debt		2,614		2,614
U.S. Government agencies		29,449		29,449
Total	$ 502	$ 44,750	$	$ 45,252

The following table sets forth the fair value of our financial assets that were measured at fair value on a recurring basis as of December 31, 2009 (in thousands):

	Level 1	Level 2	Level 3	Total
Money market funds	$ 4,157	$	$	$ 4,157
Certificates of deposit		431		431
Commercial paper		9,546		9,546
Corporate debt		2,838		2,838
U.S. Government agencies		22,800		22,800
Total	$ 4,157	$ 35,615	$	$ 39,772

The fair value of the Level 2 assets is estimated using pricing models using current observable market information for similar securities.

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

The following is a summary of available-for-sale securities as of December 31, 2010 and 2009 (in thousands):

	December 31, 2010			
	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
Money market funds	$ 502	$	$	$ 502
Certificates of deposit	1,282			1,282
Commercial paper	11,404	1		11,405
Corporate debt	2,611	3		2,614
U.S. Government agencies	29,447	10	(8)	29,449
	$ 45,246	$ 14	$ (8)	$ 45,252
Reported as:				
Cash and cash equivalents	$ 6,117	$	$	$ 6,117
Short-term investments	34,999	12	(6)	35,005
Short-term restricted investments	66			66
Long-term investments	3,197	2	(2)	3,197
Long-term restricted investments	867			867
	$ 45,246	$ 14	$ (8)	$ 45,252

	December 31, 2009			
	Amortized Cost	Unrealized Gain	Unrealized Loss	Estimated Fair Value
Money market funds	$ 4,157	$	$	$ 4,157
Certificates of deposit	431			431
Commercial paper	9,545	1		9,546
Corporate debt	2,833	5		2,838
U.S. Government agencies	22,796	10	(6)	22,800
	$ 39,762	$ 16	$ (6)	$ 39,772
Reported as:				
Cash and cash equivalents	$ 6,507	$	$	$ 6,507
Short-term investments	32,824	16	(6)	32,834
Long-term restricted investments	431			431
	$ 39,762	$ 16	$ (6)	$ 39,772

The following is a summary of the cost and estimated fair value of available-for-sale securities at December 31, 2010, by contractual maturity (in thousands):

	December 31, 2010	
	Amortized Cost	Estimated Fair Value
Mature in one year or less	$ 42,049	$ 42,055
Mature after one year through five years	3,197	3,197
	$ 42,246	$ 45,252

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

There were no securities that have had an unrealized loss for more than 12 months as of December 31, 2010 or 2009.

As of December 31, 2010, unrealized losses on available-for-sale investments are not attributed to credit risk and are considered to be temporary. The Company believes that it is more-likely-than-not that investments in an unrealized loss position will be held until maturity or the recovery of the cost basis of the investment. To date, the Company has not recorded any impairment charges on marketable securities related to other-than-temporary declines in market value.

5. Property and Equipment

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

	December 31,	
	2010	**2009**
Equipment	$ 14,507	$ 14,284
Leasehold improvement	9,577	9,667
Construction-in-progress	78	47
	24,162	23,998
Less accumulated depreciation and amortization	(22,386)	(20,190)
Property and equipment, net	$ 1,776	$ 3,808

Depreciation expense was $2.2 million, $2.5 million and $2.6 million in 2010, 2009 and 2008, respectively. At December 31, 2010 and 2009, no equipment was collateralized as security for equipment financing facilities. Depreciation expense was $39,580 in each of 2010, 2009 and 2008 for capital lease assets.

As of December 31, 2010, the Company has recorded $383,000 as a liability on its balance sheet for an asset retirement obligation associated with the estimated restoration cost for one of its leased buildings.

6. Restricted Investments

In September 2005, the Company deposited $329,000 in the form of a certificate of deposit with a financial institution as a letter of credit to secure a lease signed in August 2005 for the Company s office facility in Cupertino, California. The restriction on these funds will be released upon termination of the lease in December 2012 unless the Company exercises its lease extension option.

In January 2006, the Company deposited $61,000 in the form of a certificate of deposit with a financial institution as a letter of credit to secure a lease signed in December 2005 for capital equipment from a third party vendor for a phone system at the Cupertino facilities. The installation was completed in April 2006. The restriction on these funds will be released upon termination of the lease in March 2011.

In October 2010, the Company deposited $500,000 in the form of a certificate of deposit with a financial institution as a letter of credit to secure a lease signed in October 2010 for the Company s facility in Birmingham, Alabama. The restriction on these funds will be released upon termination of the lease in July 2021.

As of December 31, 2010 and 2009, the Company had $933,000 and $431,000, respectively, recorded as restricted investments in connection with deposits on letters of credit.

88

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

7. Long-term Debt and Commitments

Convertible Subordinated Notes

In June and July 2003, the Company completed a private placement of an aggregate of $60.0 million in convertible subordinated notes (the notes). The notes bore interest at a fixed rate of 6.25% per annum and were due on June 15, 2008. The notes were convertible at the option of the note holders into our common stock at a conversion rate of 317.4603 shares per $1,000 principal amount of notes, or $3.15 per share. Interest on the notes was payable semi-annually in arrears in June and December. From the third quarter of 2005 through October 2007, the Company exchanged an aggregate of approximately $36.4 million in principal amount of notes in individually negotiated transactions with note holders, pursuant to which the Company issued approximately 11.6 million shares of its common stock, and made cash payments in the aggregate amount of approximately $3.8 million. In June 2008, the remaining $23.6 million in aggregate principal amount of notes were converted into approximately 7.5 million shares of our common stock. As of December 31, 2010 and 2009, the remaining principal balance of the Company s notes was zero.

Alabama State Industrial Development Bonds

In conjunction with the acquisition of SBS in April 2001, the Company assumed Alabama State Industrial Development Bonds (SBS Bonds) with remaining principal payments of $1.7 million and a current interest rate of 6.35% increasing each year up to 7.20% at maturity on November 1, 2009. As part of the acquisition agreement, the Company was required to guarantee and collateralize these bonds with a letter of credit of approximately $2.4 million that the Company supported with investments deposited with a financial institution in July 2001. From 2002 to 2009, as allowed under the guarantee agreement, a total of approximately $2.4 million of this collateral was released from restriction following the exchange of the investment grade securities for corporate debt securities with a higher investment grade to conform with the Company s investment policy.

Interest payments on the SBS Bonds were due semi-annually and principal payments were due annually. Principal payments increased in annual increments from $150,000 to $240,000 over the term of the bonds until the principal was fully paid in 2009. As of December 31, 2009 and 2010, there was no remaining principal balance.

Operating Leases

In October 2010, the Company entered into a lease agreement on a 21,540 square foot facility in Birmingham, Alabama. The facility includes office, laboratory and manufacturing space and will take the place of an existing 9,400 square foot facility in Pelham, Alabama whose lease expires in September 2011. The new lease expires in July 2021 (with an option to terminate after seven years and nine months and with two options to renew the lease term for an additional five years each after the current lease expires). Total lease payments are expected to be approximately $2.9 million during the lease term.

The Company has several other lease arrangements for its facilities in California and Alabama. Under these leases, the Company is required to pay certain maintenance expenses in addition to monthly rent. Rent expense is recognized on a straight-line basis over the lease term for leases that have scheduled rental payment increases. Rent expense under all operating leases was $1.9 million, $2.1 million and $2.0 million, for the years ended December 31, 2010, 2009 and 2008, respectively.

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

Future minimum payments (including principal and interest) under these noncancelable leases are as follows (in thousands):

Year ending December 31,	Operating Leases
2011	$ 2,253
2012	2,362
2013	1,559
2014	454
Thereafter	2,020
	$ 8,648

Other Purchase Commitments

In 2005, the Company entered into a supply agreement with a vendor. The remaining minimum purchase commitments under this agreement are $500,000 per year through 2018.

8. Stockholders Equity

Common Stock

In October 2008, the shelf registration statement on Form S-3 originally filed with the SEC in October 2005 expired and in November 2008, the Company filed a new shelf registration statement on Form S-3 with the SEC, which upon being declared effective by the SEC in May 2009, allows the Company to offer up to $75 million of securities from time to time in one or more public offerings of the Company s common stock.

In September 2009, the Company completed a privately negotiated transaction to sell 4,444,444 shares of its common stock to affiliates of Venrock at a price of $2.25 per share, raising net proceeds to DURECT of approximately $9.9 million.

In July 2010, the Company entered into an equity line of credit facility with Azimuth Opportunity Ltd., or Azimuth, under which the Company may sell to Azimuth, subject to certain limitations, up to $50 million of common stock over a 24-month period. Azimuth will not be obligated to purchase shares under the equity line of credit unless specified conditions are met.

Description of Stock-Based Compensation Plans

2000 Stock Plan (Incentive Stock Plan)

In January 2000, the Company s Board of Directors and stockholders adopted the DURECT Corporation 2000 Stock Plan, under which incentive stock options and non-statutory stock options and stock purchase rights may be granted to employees, consultants and non-employee directors. The 2000 Stock Plan was amended by written consent of the Board of Directors in March 2000 and written consent of the stockholders in August 2000.

In April 2005, the Board of Directors approved certain amendments to the 2000 Stock Plan. At the Company s annual stockholders meeting in June 2005, the stockholders approved the amendments of the 2000 Stock Plan to: (i) expand the types of awards that the Company may grant to eligible service providers under the Stock Plan to include restricted stock units, stock appreciation rights and other similar types of awards (including other awards under which recipients are not required to pay any purchase or exercise price) as well as cash awards; and (ii) include certain performance criteria that may be applied to awards granted under the Stock Plan.

90

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

In April 2010, the Board of Directors approved certain amendments to the 2000 Stock Plan. At the Company s annual stockholders meeting in June 2010, the stockholders approved the amendments of the 2000 Stock Plan to: (i) provide that the number of shares that remain available for issuance will be reduced by two shares for each share issued pursuant to an award (other than an option or stock appreciation right) granted on or after the date of the 2010 Annual Meeting; (ii) expand the types of transactions that might be considered repricings and option exchanges for which stockholder approval is required; (iii) provide that shares tendered or withheld in payment of the exercise price of an option or withheld to satisfy a withholding obligation, and all shares with respect to which a stock appreciation right is exercised, will not again be available for issuance under the Stock Plan; (iv) require that options and stock appreciation rights have an exercise price or base appreciation amount that is at least fair market value on the grant date, except in connection with certain corporate transactions, and that stock appreciation rights may not have longer than a 10-year term; (v) add new performance goals that may be used to provide performance-based compensation under the Stock Plan; (vi) extend the term of the Stock Plan to the date that is ten (10) years following the stockholders meeting; and (vii) expand the treatment of outstanding awards in connection with certain changes of control of the Company to cover mergers in which the consideration payable to stockholders is not solely securities of the successor corporation. A total of 24,296,500 shares of common stock have been reserved for issuance under this plan. The plan expires in June 2020.

Options granted under the 2000 Stock Plan expire no later than ten years from the date of grant. Options may be granted with different vesting terms from time to time not to exceed five years from the date of grant. The option price of an incentive stock option granted to an employee or of a nonstatutory stock option granted to any person who owns stock representing more than 10% of the total combined voting power of all classes of stock of the Company (or any parent or subsidiary) shall be no less than 110% of the fair market value per share on the date of grant. The option price of an incentive stock option granted to any other employee shall be no less than 100% of the fair market value per share on the date of grant.

As of December 31, 2010, 3,047,999 shares of common stock were available for future grant and options to purchase 18,639,389 shares of common stock were outstanding under the 2000 Stock Plan.

2000 Directors Stock Option Plan

In March 2000, the Board of Directors adopted the 2000 Directors Stock Option Plan. A total of 300,000 shares of common stock had been reserved initially for issuance under this plan. The directors plan provides that each person who becomes a non-employee director of the Company after the effective date of the Company s initial public offering will be granted a non-statutory stock option to purchase 20,000 shares of common stock on the date on which the optionee first becomes a non-employee director of the Company. This plan also provides that each option granted to a new director shall vest at the rate of 33 1/3% per year and each annual option of 5,000 shares shall vest in full at the end of one year.

At the Company s annual stockholders meeting in June 2002, the stockholders approved an amendment of the 2000 Directors Stock Option Plan to: (i) increase the number of stock options granted to a non-employee director on the date which such person first becomes a director from 20,000 to 30,000 shares of common stock; (ii) increase the number of stock options granted to each non-employee director on the date of each annual meeting of the stockholders after which the director remains on the Board from 5,000 to 12,000 shares of common stock; and (iii) reserve 200,000 additional shares of common stock for issuance under the Directors Stock Option Plan so that the total number of shares reserved for issuance is 500,000.

In April 2005, the Board of Directors approved certain amendments to the 2000 Directors Stock Option Plan. At the Company s annual stockholders meeting in June 2005, the stockholders approved the amendments of

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

the 2000 Directors Stock Option Plan to: (i) increase the number of shares of common stock issuable under the Director s Plan by an additional 425,000 shares, to an aggregate of 925,000 shares; (ii) increase the number of option shares issued to nonemployee directors annually in connection with their continued service on the Board from 12,000 shares to 20,000 shares; and (iii) modify the vesting of such annual option grants so that such shares vest completely on the day before the first anniversary of the date of grant. The plan expired in September 2010. Awards to our non-employee directors will be granted under the 2000 Stock Plan following that date.

As of December 31, 2010, no shares of common stock were available for future grant and options to purchase 689,000 shares of common stock were outstanding under the 2000 Director s Stock Option Plan.

1993 Stock Option Plan of Southern BioSystems, Inc.

In April 2001, the Company assumed the 1993 Stock Option Plan of Southern BioSystems, Inc. (1993 SBS Plan) in connection with the acquisition of Southern BioSystems, Inc. Pursuant to the 1993 SBS Plan, incentive stock options may be granted to employees, and nonstatutory stock options may be granted to employees, directors, and consultants, of the Company and its affiliates. A total of 662,191 shares of common stock were reserved for issuance under this plan at the time the Company assumed the plan. Options granted under the 1993 SBS Plan expire no later than ten years from the date of grant. Options may be granted with different vesting terms from time to time not to exceed five years from the date of grant.

As of December 31, 2010, there were no shares of common stock available for future grant and options to purchase 54,745 shares of common stock were outstanding under the 1993 SBS Plan.

2000 Employee Stock Purchase Plan

In August 2000, the Company adopted the 2000 Employee Stock Purchase Plan. This purchase plan is implemented by a series of overlapping offering periods of approximately 24 months duration, with new offering periods, other than the first offering period, beginning on May 1 and November 1 of each year and ending April 30 and October 31, respectively, two years later. The purchase plan allows eligible employees to purchase common stock through payroll deductions at a price equal to the lower of 85% of the fair market value of the Company s common stock at the beginning of each offering period or at the end of each purchase period. The initial offering period commenced on the effectiveness of the Company s initial public offering.

In April 2010, the Board of Directors approved certain amendments to the 2000 Employee Stock Purchase Plan. At the Company s annual stockholders meeting in June 2010, the stockholders approved the amendments of the 2000 Employee Stock Purchase Plan to: (i) increase the number of shares of our common stock authorized for issuance under the ESPP by 250,000 shares; (ii) extend the term of the ESPP to the date that is ten (10) years following the stockholders meeting; (iii) provide for six-month consecutive offering periods beginning on November 1, 2010; (iv) revise certain provisions to reflect the final regulations issued under Section 423 of the Code by the Internal Revenue Service; and (v) provide for the cash-out of options outstanding under an offering period in effect prior to the consummation of certain corporate transactions as an alternative to providing for a final purchase under such offering period.

The plan expires in June 2020. A total of 2,200,000 shares of common stock have been reserved for issuance under this plan. As of December 31, 2010, 720,537 shares of common stock were available for future grant and 1,479,463 shares of common stock have been issued under the 2000 Employee Stock Purchase Plan.

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

As of December 31, 2010, shares of common stock reserved for future issuance consisted of the following:

	December 31, 2010
Warrants outstanding	770
Stock options outstanding	19,383,134
Stock options available for grant	3,047,999
Employee Stock Purchase Plan	720,537
	23,152,440

A summary of stock option activity under all stock-based compensation plans is as follows:

	Number of Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value (in millions)
Outstanding at December 31, 2007	11,423,967	$ 4.41	7.09	$ 26.4
Options granted	2,976,645	$ 5.66		
Options exercised	(210,679)	$ 2.46		
Options forfeited	(419,163)	$ 4.84		
Options expired	(70,800)	$ 8.13		
Outstanding at December 31, 2008	13,699,970	$ 4.68	6.61	$ 2.9
Options granted	5,153,930	$ 2.69		
Options exercised	(101,849)	$ 1.54		
Options forfeited	(1,038,513)	$ 4.05		
Options expired	(1,085,748)	$ 4.81		
Outstanding at December 31, 2009	16,627,790	$ 4.11	6.72	$ 1.5
Options granted	3,783,677	$ 2.24		
Options exercised	(114,888)	$ 1.99		
Options forfeited	(436,373)	$ 3.36		
Options expired	(477,072)	$ 7.65		
Outstanding at December 31, 2010	19,383,134	$ 3.68	6.36	$ 10.4
Exercisable at December 31, 2010	12,459,705	$ 4.01	5.32	$ 5.0
Vested and expected to vest at December 31, 2010	18,968,021	$ 3.71	6.29	$ 10.0

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (i.e., the difference between the Company s closing stock price on the last trading day of 2010 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2010. This amount changes based on the fair market value of the Company s common stock. The total intrinsic value of options exercised was $110,000, $101,000 and $455,000 for the years

ended December 31, 2010, 2009 and 2008, respectively.

In January 2010, the Company granted its employees stock options to purchase 921,000 shares of the Company s common stock, which vested immediately on the grant date. The weighted-average grant-date fair value of all options granted with exercise prices equal to fair market value was $1.53 in 2010, $1.95 in 2009 and $4.02 in 2008. There were no options granted with exercise prices lower than fair market value in 2010, 2009 and 2008.

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

Expenses for non-employee stock options are recorded over the vesting period of the options, with the value determined by the Black-Scholes option valuation method and remeasured over the vesting term.

As of December 31, 2010, the Company had four stock-based employee compensation plans, which are described above. The employee stock-based compensation cost that has been included in the statements of operations was $7.8 million, $11.4 million and $8.5 million for the years ended December 31, 2010, 2009 and 2008, repectively. Because the Company had a net operating loss carryforward as of December 31, 2010, no excess tax benefits for the tax deductions related to stock-based compensation expense were recognized in our statement of operations. Additionally, no incremental tax benefits were recognized from stock options exercised during 2010, which would have resulted in a reclassification to reduce net cash provided by operating activities with an offsetting increase in net cash provided by financing activities.

Determining Fair Value

Valuation and Amortization Method. The Company estimates the fair value of stock options granted using the Black-Scholes option valuation model. For options granted before January 1, 2006, the Company amortizes the fair value on an accelerated basis. For options granted on or after January 1, 2006, the Company amortizes the fair value on a straight-line basis. All options are amortized over the requisite service periods of the awards, which are generally the vesting periods.

Expected Term. The expected term of options granted represents the period of time that the options are expected to be outstanding. In 2008, 2009 and 2010, the Company determined the expected life using historical options experience. This develops the expected life by taking the weighted average of the actual life of options exercised and cancelled and assumes that outstanding options are exercised uniformly from the current holding period through the end of the contractual life.

Expected Volatility. The Company estimates the volatility of its common stock at the date of grant based on the historical volatility of the Company s common stock.

Risk-Free Rate. The Company bases the risk-free rate that it uses in the Black-Scholes option valuation model on the implied yield in effect at the time of option grant on U.S. Treasury zero-coupon issues with substantially equivalent remaining terms.

Dividends. The Company has never paid any cash dividends on its common stock and the Company does not anticipate paying any cash dividends in the foreseeable future. Consequently, the Company uses an expected dividend yield of zero in the Black-Scholes option valuation model.

The Company used the following assumptions to estimate the fair value of options granted (including fully vested options issued in January 2010) and shares purchased under its employee stock plans and stock purchase plan for the years ended December 31, 2010, 2009 and 2008:

	Year ended December 31,		
	2010	**2009**	**2008**
Stock Options			
Risk-free rate	1.53-2.92%	2.0-3.0%	1.7-3.5%
Expected dividend yield			
Expected term (in years)	5.5	6.0	6.0
Volatility	75-87%	82-87%	81-85%
Forfeiture rate	5.33%	6.1%	12.9%

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

	Year ended December 31,		
	2010	2009	2008
Employee Stock Purchase Plan			
Risk-free rate	0.16-1.45%	0.17-2.37%	1.1-4.0%
Expected dividend yield			
Expected term (in years)	1.25	1.25	1.25
Volatility	59-163%	57-150%	51-95%

There were 183,687, 191,414 and 222,009 shares purchased under the Company s employee stock purchase plan during the years ended December 31, 2010, 2009 and 2008, respectively. Included in the statement of operations for the year ended December 31, 2010, 2009 and 2008 was $307,000, $392,000 and $462,000, respectively, in stock-based compensation expense related to the amortization of expenses related to shares purchased under the Company s employee stock purchase plan.

As of December 31, 2010, $8.9 million of total unrecognized compensation costs related to nonvested stock options is expected to be recognized over the respective vesting terms of each award through 2012. The weighted average term of the unrecognized stock-based compensation expense is 1.9 years.

The following table summarizes information about stock options outstanding at December 31, 2010:

	Options Outstanding				Options Exercisable	
Range of Exercise Price	Number of Options Outstanding	Weighted-Average Remaining Contractual Life (In years)	Weighted-Average Exercise Price	Number of Options Exercisable	Weighted-Average Exercise Price
$1.34 2.09	2,289,288	6.33	$1.92	1,272,771	$1.81
$2.10 2.18	3,303,290	9.00	$2.18	889,064	$2.18
$2.20 3.10	1,647,676	5.86	$2.54	1,142,937	$2.53
$3.11 3.11	2,448,698	7.97	$3.11	1,091,215	$3.11
$3.12 3.76	2,077,232	3.88	$3.29	2,027,232	$3.29
$3.77 4.34	2,518,868	5.85	$4.22	2,017,672	$4.20
$4.35 5.27	2,201,543	5.04	$5.16	2,127,093	$5.17
$5.38 5.86	74,000	6.48	$5.55	54,750	$5.54
$5.89 5.89	1,973,420	6.93	$5.89	1,005,602	$5.89
$5.91 12.04	849,119	1.63	$8.42	831,369	$8.46
$1.34 12.04	19,383,134	6.36	$3.68	12,459,705	$4.01

The Company received $229,000, $157,000, and $518,000 in cash from option exercises under all stock-based compensation plans for the years ended December 31, 2010, 2009 and 2008, respectively.

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. The Black-Scholes model requires the input of highly subjective assumptions including the expected stock price volatility. The Company s stock-based awards to employees have characteristics significantly different from those of traded options. Changes in the subjective input assumptions can materially affect the fair value estimate of stock options and other awards.

Under the Black-Scholes option-pricing model, the Company historically estimated the expected life of options using its best estimate of employee exercise behavior at the time. This estimate considered the vesting period for the employee stock options and a reasonable assumption about the post-vesting holding period.

95

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

Stockholder Rights Plan

On July 6, 2001, the Board of Directors adopted a Stockholder Rights Plan. The rights issued pursuant to the plan expire on July 6, 2011 and are exercisable ten days after a person or group either (a) announces the acquisition of 17.5% or more of the Company s outstanding common stock or (b) commences a tender offer, which would result in ownership by the person or group of 17.5% or more of the Company s outstanding common stock. Upon exercise, all rights holders except the potential acquiror will be entitled to acquire the Company s common stock at a discount. Under certain circumstances, the Company s Board of Directors may also exchange the rights (other than those owned by the acquiror or its affiliates) for the Company s common stock at an exchange ratio of one share of common stock per right. The Company is entitled to redeem the rights at any time on or before the tenth day following acquisition by a person or group of 17.5% or more of the Company s common stock.

9. Write-Down of Deferred Royalties and Commercial Rights

In December 2008, the Company recorded a $13.5 million write-down of the carrying value of deferred royalties and commercial rights associated with CHRONOGESIC. In 2000, the Company recorded the fair value of common stock and a warrant issued to ALZA Corporation in connection with an amended agreement related to CHRONOGESIC as additional paid-in capital and a contra-equity account referred to as deferred royalties and commercial rights. At the end of 2008, the Company made the strategic decision that other research and development programs would take priority over CHRONOGESIC and recorded this write-down given the fact that the Company had no plans in the foreseeable future to actively attempt to develop CHRONOGESIC.

10. Income Taxes

The Company accounts for income taxes using the liability method under ASC 740, *Income Taxes*. Under this method, deferred tax assets and liabilities are determined based on temporary differences resulting from the different treatment of items for tax and financial reporting purposes. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to reverse. Additionally, the Company must assess the likelihood that deferred tax assets will be recovered as deductions from future taxable income. The Company has provided a full valuation allowance on the Company s deferred tax assets because the Company believes it is more likely than not that its deferred tax assets will not be realized. The Company evaluates the realizability of its deferred tax assets on a quarterly basis. Currently, there is no provision for income taxes as the Company has incurred losses to date.

The reconciliation of income tax expenses (benefit) at the statutory federal income tax rate of 34% to net income tax benefit included in the statement of operations for the years ended December 31, 2010, 2009 and 2008 is as follows (in thousands):

	Year Ended December 31,		
	2010	2009	2008
U.S. federal taxes (benefit) at statutory rate	$ (7,782)	$ (10,296)	$ (14,928)
State taxes			
Unutilized net operating loss	6,792	8,517	8,763
Non-deductible stock-based compensation	1,224	1,763	1,513
Write-down of deferred royalties and commercial rights			4,583
Other	(234)	16	69
Total	$	$	$

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

Deferred tax assets and liabilities reflect the net tax effects of net operating loss and research and other credit carryforwards and the temporary differences between the carrying amounts of assets and liabilities for financial reporting and the amounts used for income tax purposes. Significant components of the Company s deferred tax assets are as follows (in thousands):

	December 31,	
	2010	2009
Deferred tax assets:		
Net operating loss carryforwards	$ 87,070	$ 79,692
Research and other credits	8,183	7,300
Capitalized research and development expenses	3,702	3,286
Deferred revenue	6,953	8,735
Stock based compensation	6,831	5,278
Other	3,125	2,952
Total deferred tax assets	115,864	107,243
Valuation allowance for deferred tax assets	(115,864)	(107,243)
Net deferred tax assets	$	$

Realization of deferred tax assets is dependent upon future earnings, if any, the timing and amount of which are uncertain. Accordingly, the net deferred tax assets have been fully offset by a valuation allowance. The valuation allowance increased by $8.6 million, $10.8 million and $10.4 million during 2010, 2009 and 2008, respectively.

As of December 31, 2010, the Company had net operating loss carryforwards for federal income tax purposes of approximately $232.5 million, which expire in the years 2018 through 2030 and federal research and development tax credits of approximately $4.7 million which expire at various dates beginning in 2018 through 2030, if not utilized.

As of December 31, 2010, the Company had net operating loss carryforwards for state income tax purpose of approximately $142.6 million, which expire in the years 2012 through 2030, if not utilized, and state research and development tax credits of approximately $5.1 million, which do not expire.

Utilization of the net operating losses may be subject to a substantial annual limitation due to federal and state ownership change limitations. The annual limitation may result in the expiration of net operating losses before utilization.

At December 31, 2009 and December 31, 2010, the Company had unrecognized tax benefits of approximately $3.8 million and $4.2 million, respectively (none of which, if recognized, would favorably affect the Company s effective tax rate). The Company does not believe there will be any material changes in its unrecognized tax positions over the next twelve months.

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (in thousands):

	December 31,	
	2010	2009
Balance at beginning of the year	$ 3,758	$ 3,260
Increases (decrease) related to prior year tax positions		9
Increases related to current year tax positions	471	489
Settlements		
Reductions due to lapse of applicable statute of limitations		
Balance at end of the year	$ 4,229	$ 3,758

Interest and penalty costs related to unrecognized tax benefits, if any, are classified as a component of interest income and other income (expense), net in the accompanying Statements of Operations. The Company did not recognize any interest and penalty expense related to unrecognized tax benefits for the years ended December 31, 2010, 2009 and 2008.

The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. The Company is subject to U.S. federal and state income tax examination for calendar tax years ending 1998 through 2010.

11. Reduction in Force

In March 2009, the Company reduced the size of its workforce by 41 employees or approximately 24% of its headcount. The goal of this action was to better align its cost structure with anticipated revenues and operating expenses, while not compromising the Company s key corporate objectives for that year. The Company substantially completed this headcount reduction during the first quarter of 2009, and incurred approximately $443,000 in severance costs for the impacted employees, of which $384,000 was recorded in research and development expenses and $59,000 was recorded in selling, general and administrative expenses in 2009. All severance costs were paid during 2009.

12. Government Grants

In the fourth quarter of 2010, DURECT was notified that it had been awarded grants totaling $733,000 under the Patient Protection and Affordable Care Act of 2010 for three qualifying therapeutic discovery projects. The Company received this funding in November 2010 and recorded the amount received as other income on its Statements of Operations in the fourth quarter of 2010.

13. Unaudited Selected Quarterly Financial Data (in thousands, except per share amounts)

	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	2010	2009	2010	2009	2010	2009	2010	2009
Revenue	$ 7,666	$ 6,327	$ 7,313	$ 4,877	$ 8,116	$ 8,378	$ 8,496	$ 4,878
Net loss	$ (6,626)	$ (8,656)	$ (6,309)	$ (7,508)	$ (4,647)	$ (5,535)	$ (5,316)	$ (8,589)
Basic and diluted net loss per share	$ (0.08)	$ (0.11)	$ (0.07)	$ (0.09)	$ (0.05)	$ (0.07)	$ (0.06)	$ (0.10)

Table of Contents

DURECT CORPORATION

NOTES TO FINANCIAL STATEMENTS (Continued)

14. Subsequent Event

In February 2011, the Company and Nycomed entered into an amendment (Amendment) to the Development and License Agreement entered into between the parties dated November 29, 2006 covering the development and commercialization of POSIDUR in the European Union (E.U.) and other selected countries (the Agreement).

Prior to the Amendment, the Agreement provided for the two parties to jointly direct and equally fund the non-clinical and Chemistry Manufacturing and Controls (CMC) activities for POSIDUR for the U.S. and E.U. territories. The Amendment now provides that during the period commencing from January 1, 2011 until a specified period after the results are delivered from DURECT to Nycomed from DURECT s U.S. Phase III clinical trial for POSIDUR referred to as BESST (Bupivacaine Effectiveness and Safety in SABER Trial) (such period the Interim Period), DURECT shall assume full funding responsibility and final decision making authority for these activities. Furthermore, during this Interim Period, Nycomed s development and commercialization responsibility relating to POSIDUR for the territory licensed to Nycomed shall be confined to bringing its E.U. Phase IIb Clinical Trial in shoulder surgery to a full completion. Unless the Agreement is otherwise terminated, at the conclusion of the Interim Period, under the Amendment, Nycomed would resume joint control and shared funding responsibility with DURECT for the non-clinical and Chemistry Manufacturing and Controls (CMC) activities for POSIDUR for the U.S. and E.U. territories. Prior to the Amendment, Nycomed had the right to terminate the Agreement after specified periods after data was received from certain clinical trials of POSIDUR in the E.U. and the U.S., including BESST. The foregoing right was modified by the Amendment to provide that Nycomed may exercise its right to terminate the Agreement at its sole election if BESST data was not available by December 31, 2011.

Table of Contents

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.
Not applicable.

Item 9A. Controls and Procedures.

Disclosure Controls and Procedures

As required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15, DURECT s management, including our Chief Executive Officer and Chief Financial Officer, conducted an evaluation as of the end of the period covered by this report, of the effectiveness of DURECT s disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e) and 15d-15(e). Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that DURECT s disclosure controls and procedures were effective as of the end of the period covered by this report.

Management s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision of our Chief Executive Officer and Chief Financial Officer and with the participation of our management, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2010 based on the framework in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on that evaluation, our management concluded that our internal control over financial reporting was effective as of December 31, 2010.

Our independent registered public accountants, Ernst & Young LLP, audited the financial statements included in this Annual Report on Form 10-K and have issued an audit report on our internal control over financial reporting. The report on the audit of internal control over financial reporting appears below.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during our last fiscal quarter that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of DURECT Corporation

We have audited DURECT Corporation s internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). DURECT Corporation s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management s Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed 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. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, DURECT Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the balance sheets of DURECT Corporation as of December 31, 2010 and 2009, the related statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2010 of DURECT Corporation and the financial statement schedule listed in the Index at Item 15(a)(2) and our report dated March 3, 2011 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Palo Alto, California

March 3, 2011

Table of Contents

Item 9B. Other Information.
None

PART III

The definitive proxy statement for our 2011 annual meeting of stockholders, when filed, pursuant to Regulation 14A of the Securities Exchange Act of 1934, will be incorporated by reference into this Form 10-K pursuant to General Instruction G (3) of Form 10-K and will provide the information required under Part III (Items 10-14), except for the information with respect to our executive officers, which is included in Part I Executive Officers of the Registrant.

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) The following documents are filed as part of this report:

(1) *Financial Statements*

See Item 8 of this Form 10-K

(2) *Financial Statement Schedules*

Schedule II Valuation and Qualifying Accounts

Schedules not listed above have been omitted because the information required to be set forth therein is not applicable or is shown in the financial statements or notes thereto.

(3) Exhibits are incorporated herein by reference or are filed in accordance with Item 601 of Regulation S K.

Number	Description
2.1	Agreement and Plan of Merger dated April 18, 2001, among the Company, Target and Magnolia Acquisition Corporation (incorporated by reference to Exhibit 2.1 to our Current Report on Form 8-K (File No. 000-31615) filed on May 15, 2001).
2.2	Agreement and Plan of Merger dated August 15, 2003, among the Company, Birmingham Polymers, Inc., Absorbable Polymer Technologies, Inc. and the Principal Shareholders of Absorbable Polymer Technologies, Inc. (incorporated by reference to Exhibit 2.2 to our Registration Statement on Form S-3, as amended (File No. 333-108396), initially filed on August 29, 2003).
3.3	Amended and Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.3 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
3.4	Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Company (incorporated by reference to Exhibit 3.4 to our Post-Effective Amendment No. 1 to our Registration Statement on Form S-3, filed on July 1, 2010.
3.5	Amended and Restated Bylaws of the Company (incorporated by reference to Exhibit 3.5 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).

3.6	Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of DURECT Corporation (incorporated by reference to Exhibit 3.3 to our Registration Statement on Form S-3 (File No. 333-128979) initially filed on October 13, 2005).

Table of Contents

Number	Description
3.7	Certificate of Amendment to Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of DURECT Corporation (incorporated by reference to Exhibit 3.7 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on August 5, 2010).
4.2	Second Amended and Restated Investors Rights Agreement (incorporated by reference to Exhibit 4.2 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
4.3	Preferred Shares Rights Agreement, dated as of July 6, 2001, between the Company and EquiServe Trust Company, N.A. including the form of Certificate of Designation, the form of the Rights Certificate and the Summary of Rights attached thereto as Exhibits A, B and C, respectively (incorporated by reference to Exhibit 1 to our Registration Statement on Form 8-A (File No. 000-31615) filed on July 10, 2001).
10.1+	Form of Indemnification Agreement between the Company and each of its Officers and Directors (incorporated by reference to Exhibit 10.1 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.2+	1998 Stock Option Plan (incorporated by reference to Exhibit 10.2 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.3+	2000 Stock Plan, as amended and restated (incorporated by reference to Exhibit 10.3 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on November 4, 2010).
10.4+	2000 Employee Stock Purchase Plan (incorporated by reference to Exhibit 10.4 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.5+	2000 Directors Stock Option Plan (incorporated by reference to Exhibit 10.5 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.6**	Second Amended and Restated Development and Commercialization Agreement between the Company and ALZA Corporation effective April 28, 1999 (incorporated by reference to Exhibit 10.6 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.7**	Product Acquisition Agreement between the Company and ALZA Corporation dated as of April 14, 2000 (incorporated by reference to Exhibit 10.7 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.8	Amended and Restated Loan and Security Agreement between the Company and Silicon Valley Bank dated as of October 28, 1998 (incorporated by reference to Exhibit 10.8 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.9**	Manufacturing and Supply Agreement between Neuro-Biometrix, Inc. and Novel Biomedical, Inc. dated as of November 24, 1997 (incorporated by reference to Exhibit 10.9 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.10**	Master Services Agreement between the Company and Quintiles, Inc. dated as of November 1, 1999 (incorporated by reference to Exhibit 10.10 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.11	Modified Net Single Tenant Lease Agreement between the Company and DeAnza Enterprises, Ltd. dated as of February 18, 1999 (incorporated by reference to Exhibit 10.11 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.12	Sublease Amendment between the Company and Ciena Corporation dated as of November 29, 1999 and Sublease Agreement between Company and Lightera Networks, Inc. dated as of March 10, 1999 (incorporated by reference to Exhibit 10.12 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).

Table of Contents

Number	Description
10.13**	Project Proposal between the Company and Chesapeake Biological Laboratories, Inc. dated as of October 11, 1999 (incorporated by reference to Exhibit 10.13 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.17	Common Stock Purchase Agreement between the Company and ALZA Corporation dated April 14, 2000 (incorporated by reference to Exhibit 10.17 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.18	Warrant issued to ALZA Corporation dated April 14, 2000 (incorporated by reference to Exhibit 10.18 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.19	Amended and Restated Market Stand-off Agreement between the Company and ALZA Corporation dated as of April 14, 2000 (incorporated by reference to Exhibit 10.19 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.20**	Asset Purchase Agreement between the Company and IntraEAR, Inc. dated as of September 24, 1999 (incorporated by reference to Exhibit 10.20 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.21	Warrant issued to Silicon Valley Bank dated December 16, 1999 (incorporated by reference to Exhibit 10.21 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.22	Amendment to Second Amended and Restated Investors Rights Agreement dated as of April 14, 2000 (incorporated by reference to Exhibit 10.22 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.23**	Master Agreement between the Company and Pacific Data Designs, Inc. dated as of July 6, 2000 (incorporated by reference to Exhibit 10.23 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.24**	Master Services Agreement between the Company and Clinimetrics Research Associates, Inc. dated as of July 11, 2000 (incorporated by reference to Exhibit 10.24 to our Registration Statement on Form S-1, as amended (File No. 333-35316), initially filed on April 20, 2000).
10.25**	Supply Agreement between the Company and Mallinckrodt, Inc. dated as of October 1, 2000 (incorporated by reference to Exhibit 10.25 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 30, 2001).
10.26	Lease between Sobrato Development Companies #850 and the Company (incorporated by reference to Exhibit 10.26 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on November 13, 2001).
10.27	Southern BioSystems, Inc. 1993 Stock Option Plan (as amended) (incorporated by reference to Exhibit 4.1 to our Registration Statement on Form S-8 (File No. 333-61224) filed on May 18, 2001).
10.28	Southern Research Technologies, Inc. 1995 Nonqualified Stock Option Plan (as amended) (incorporated by reference to Exhibit 4.2 to our Registration Statement on Form S-8 (File No. 333-61224) filed on May 18, 2001).
10.29**	Feasibility, Development and Commercialization Agreement between Southern BioSystems, Inc., an Alabama corporation and wholly-owned subsidiary of the Company (now merged into the Company), and Voyager Pharmaceutical Corporation dated as of July 22, 2002 (incorporated by reference to Exhibit 10.29 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on November 14, 2002).

Table of Contents

Number	Description
10.30**	License & Option Agreement and Mutual Release between Southern BioSystems, Inc, an Alabama corporation and wholly-owned subsidiary of the Company (now merged into the Company), and Thorn BioScience LLC dated as of July 26, 2002 (incorporated by reference to Exhibit 10.30 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on November 14, 2002).
10.31**	Third Amended and Restated Development and Commercialization Agreement between the Company and ALZA Corporation dated as of October 1, 2002 (incorporated by reference to Exhibit 10.31 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on November 14, 2002).
10.32**	Development and License Agreement between the Company, Southern BioSystems, Inc, an Alabama corporation and wholly-owned subsidiary of the Company (now merged into the Company), and BioPartners, GmbH dated as of October 18, 2002 (incorporated by reference to Exhibit 10.32 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 14, 2003).
10.33**	Development, Commercialization and Supply License Agreement between the Company and Endo Pharmaceuticals Inc. dated as of November 8, 2002 (incorporated by reference to Exhibit 10.33 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 14, 2003).
10.34**	Development and License Agreement between the Company, Southern BioSystems, Inc., an Alabama corporation and wholly-owned subsidiary of the Company (now merged into the Company), and Pain Therapeutics, Inc. dated as of December 19, 2002 (incorporated by reference to Exhibit 10.34 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 14, 2003).
10.35	Sublease between the Company and Norian Corporation with commencement date of January 1, 2004 (incorporated by reference to Exhibit 10.35 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 11, 2004).
10.36	Lease between the Company and Renault & Handley Employee Investments Co. with commencement date of January 1, 2005 (incorporated by reference to Exhibit 10.36 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 11, 2004).
10.37	Amendment to Development, Commercialization and Supply License Agreement between the Company and Endo Pharmaceuticals Inc. dated as of January 28, 2004 (incorporated by reference to Exhibit 10.37 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 11, 2004).
10.38	Indenture of Lease between the Company and the Board of Trustees of the University of Alabama dated as of May 1, 2004 (incorporated by reference to Exhibit 10.38 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on August 4, 2004).
10.39**	License and Commercial Agreement between the Company and NeuroSystec Corporation dated as of May 13, 2004 (incorporated by reference to Exhibit 10.39 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on August 4, 2004).
10.40	Commercial Lease between the Company and EWE, Inc. dated as of September 21, 2004 (incorporated by reference to Exhibit 10.40 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on November 5, 2004).
10.41**	License agreement between the Company and Endo Pharmaceuticals, Inc. dated as of March 10, 2005 (incorporated by reference to Exhibit 10.41 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on May 6, 2005).
10.42	Indenture of Lease between the Company and the Board of Trustees of the University of Alabama dated as of April 25, 2005 (incorporated by reference to Exhibit 10.42 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on August 4, 2005).
10.43	Third Addendum to Lease between the Company and Garaventa Properties dated as of July 8, 2005 (incorporated by reference to Exhibit 10.43 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on October 13, 2005).

Table of Contents

Number	Description
10.44	Lease between the Company and RWC, LLC dated as of September 1, 2005 (incorporated by reference to Exhibit 10.44 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on October 13, 2005).
10.45**	Amendment dated December 21, 2005 to Development and License Agreement dated December 19, 2002 between the Company and Pain Therapeutics, Inc. (incorporated by reference to Exhibit 10.45 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 16, 2006).
10.46**	Sucrose Acetate Isobutyrate Pharmaceutical Grade Supply Agreement between the Company and Eastman Chemical Company dated as of December 30, 2005 (incorporated by reference to Exhibit 10.46 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 16, 2006).
10.47	Indenture of Lease between the Company and the Board of Trustees of the University of Alabama dated as of October 17, 2006 (incorporated by reference to Exhibit 10.47 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 15, 2007).
10.48**	Development and License Agreement between the Company and NYCOMED Danmark ApS dated as of November 29, 2006 (incorporated by reference to Exhibit 10.48 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 15, 2007).
10.49**	License Agreement between the Company and EpiCept Corporation dated as of December 20, 2006 (incorporated by reference to Exhibit 10.49 to our Annual Report on Form 10-K (File No. 000-31615) filed on March 15, 2007).
10.50	Lease between the Company and KLP Properties dated as of April 23, 2008 (incorporated by reference to Exhibit 10.50 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on August 8, 2008).
10.51	Amendment No. 1 to License Agreement between the Company and EpiCept Corporation dated as of September 12, 2008 (incorporated by reference to Exhibit 10.51 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on November 4, 2008).
10.52**	Development and License Agreement between the Company and Alpharma Ireland Limited dated as of September 19, 2008 (incorporated by reference to Exhibit 10.52 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on November 4, 2008).
10.53	Amendment to Commercial Lease between the Company and EWE, Inc. effective December 23, 2008 (incorporated by reference to Exhibit 10.53 to our Annual Report on Form 10-K (File No. 000-31615) filed with the SEC on March 10, 2009).
10.54	First Lease Extension between the Company and Renault & Handley Employee Investments Co. effective March 1, 2009 (incorporated by reference to Exhibit 10.54 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on May 7, 2009).
10.55**	Excipient Manufacturing and Supply Agreement between King Pharmaceuticals, Inc. and the Company dated as of August 5, 2009 (incorporated by reference to Exhibit 10.55 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on November 2, 2009).
10.56	Second Amendment to Lease between De Anza Enterprises and the Company dated as of August 6, 2009 (incorporated by reference to Exhibit 10.56 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on November 2, 2009).
10.57**	Amendment No. 1 to Development and License Agreement between the Company and Nycomed Danmark, ApS dated February 18, 2010 (incorporated by reference to Exhibit 10.57 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on May 10, 2010).
10.58	Amendment to Commercial Real Estate Lease between the Company and EWE, Inc. effective May 10, 2010 (incorporated by reference to Exhibit 10.58 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on August 5, 2010).

Table of Contents

Number	Description
10.59**	Development and License Agreement between the Company and Hospira, Inc. dated June 1, 2010 (incorporated by reference to Exhibit 10.59 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on August 5, 2010).
10.60	Supply Agreement between the Company and Hospira, Inc. dated June 1, 2010 (incorporated by reference to Exhibit 10.60 to our Quarterly Report on Form 10-Q (File No. 000-31615) filed on August 5, 2010).
10.61	Common Stock Purchase Agreement between DURECT Corporation and Azimuth Opportunity Ltd., dated July 1, 2010 (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K (File No. 000-31615) filed on July 1, 2010).
10.62*	Lease between the Company and DRA/CLP Riverchase Center Birmingham, LLC dated as of October 19, 2010.
10.63*	Third Amendment to Lease between De Anza Enterprises and the Company dated as of December 21, 2010.
12.1*	Ratio of Earnings to Fixed Charges.
23.1*	Consent of Independent Registered Public Accounting Firm.
24.1	Power of Attorney (see signature page of this Form 10-K).
31.1*	Rule 13a-14(a) Section 302 Certification.
31.2*	Rule 13a-14(a) Section 302 Certification.
32.1*	Certificate pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certificate pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith.

** Confidential treatment granted with respect to certain portions of this Exhibit.

Refiled with additional disclosure previously treated as confidential.

\+ Indicates a management contract or compensatory plan or arrangement.

Table of Contents

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

Year Ended December 31, 2010, 2009 and 2008

(in thousands)

	Balance at beginning of the year	Provision	Recoveries/ Write-Offs	Balance at end of the year
December 31, 2010				
Allowance for doubtful accounts	$ 103	$ 8	$ (4)	$ 107
December 31, 2009				
Allowance for doubtful accounts	$ 113	$	$ (10)	$ 103
December 31, 2008				
Allowance for doubtful accounts	$ 49	$ 74	$ (10)	$ 113

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

DURECT CORPORATION

By: /s/ JAMES E. BROWN
James E. Brown

President and Chief Executive Officer

Date: March 3, 2011

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints James E. Brown and Felix Theeuwes, jointly and severally, his or her attorneys-in-fact, each with the power of substitution, for him or her in any and all capacities, to sign any amendments to this Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his or her substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ JAMES E. BROWN **James E. Brown**	President, Chief Executive Officer and Director (Principal Executive Officer)	March 3, 2011
/s/ FELIX THEEUWES **Felix Theeuwes**	Chairman and Chief Scientific Officer	March 3, 2011
/s/ MATTHEW J. HOGAN **Matthew J. Hogan**	Chief Financial Officer (Principal Accounting Officer)	March 3, 2011
/s/ SIMON X. BENITO **Simon X. Benito**	Director	March 3, 2011
/s/ TERRENCE F. BLASCHKE **Terrence F. Blaschke**	Director	March 3, 2011
/s/ MICHAEL D. CASEY **Michael D. Casey**	Director	March 3, 2011

/s/ David R. Hoffmann **David R. Hoffmann**	Director	March 3, 2011
/s/ Armand P. Neukermans **Armand P. Neukermans**	Director	March 3, 2011
/s/ Jon S. Saxe **Jon S. Saxe**	Director	March 3, 2011